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BusinessWeek

JUNE 25, 2007 / www.businessweek.com

Telecom Back From The Dead

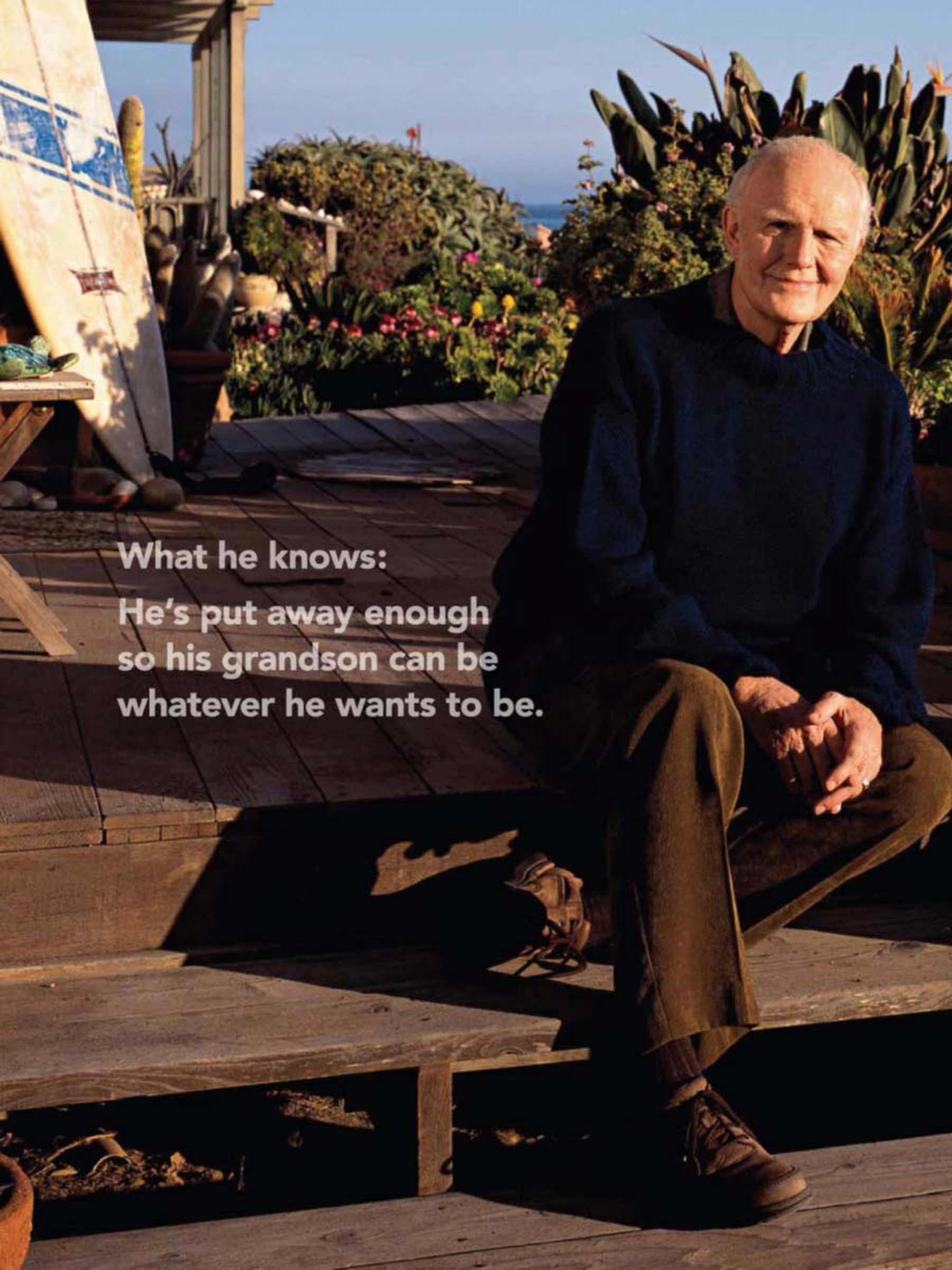
How a business almost buried by the dot-com bust is reviving itself and invigorating the economy

by SPENCER E. ANTE
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BLOOMBERG
Lessons of the
CEO Mayor
(PAGE 58)

FORECLOSURE
'RESCUES'
Why They Hurt
Homeowners
(PAGE 30)



A photograph of an older man with white hair, smiling, sitting on a wooden deck. He is wearing a dark blue sweater and brown trousers. To his left, a surfboard with blue and white graphics leans against a wooden structure. The background is filled with lush green plants and flowers, with a glimpse of the ocean and a clear blue sky in the distance. The scene is bathed in warm, golden light, suggesting late afternoon or early morning.

What he knows:
He's put away enough
so his grandson can be
whatever he wants to be.



**What he knows:
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a dinosaur.**

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- ☐ Build a house
- ☐ Perfect a foreign accent
- ☐ Attempt to break a world record
- ☐ Invent something
- ☐ Climb Mount Everest
- ☐ Celebrate the Fourth of July outside the U.S.
- ☐ Visit the Taj Mahal
- ☐ See the cherry blossoms in D.C.
- ☐ Save a life
- ☐ Learn to survive in the wilderness
- ☐ Stand on the equator
- ☐ Ride a boat through a fjord
- ☐ Visit all 50 states
- ☐ Become financially independent
- ☐ Watch a meteor shower
- ☐ Tour MoMA with a personal guide
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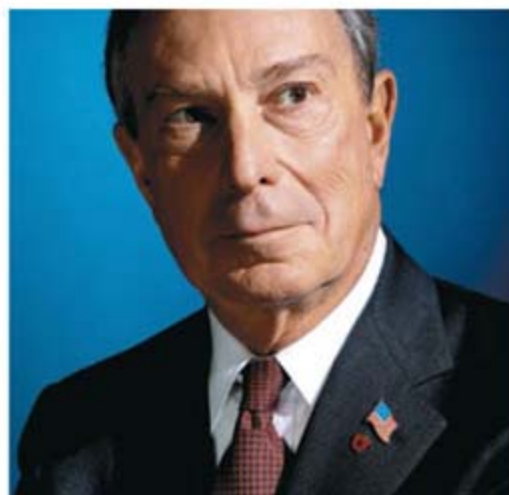
Jim Cooper explains the Fed's dilemma: Raising rates would halt inflation—but further depress the housing market



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**While others are going back to the drawing board,
we're heading back to the podium.**



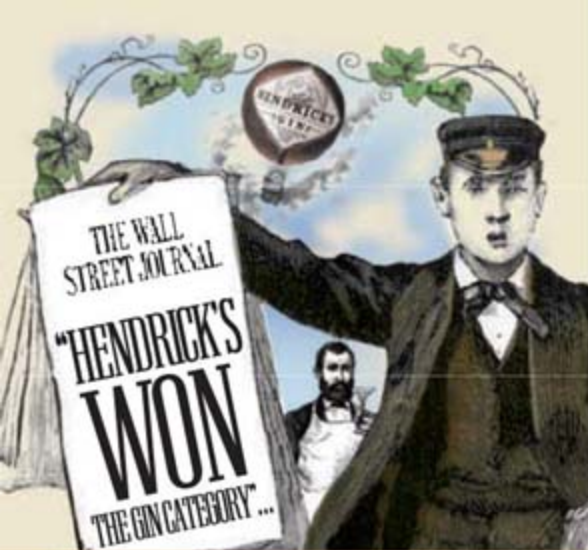
Nissan's VQ engine has been named one of *Ward's* "10 Best Engines" for the 13th year in a row: The Maxima's 255-hp V6 engine delivers awesome power, torque and brilliant throttle-response in any speed range. Cementing its place in the winners' circle yet again. To learn more, visit **NissanUSA.com**.

Nissan Maxima



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THE WALL STREET JOURNAL.

When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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All the News, Twice a Day

Everyone wants to keep up with important business events. But who has the time to read all those newspapers, magazines, and blogs, still do their job, and make it home before dawn the next day? *BusinessWeek's* new **Executive Summary** will cut through the clutter and help keep you keep abreast of the most significant stories from around the globe. From the latest on Rupert Murdoch's \$5 billion play for *The Wall Street Journal* to the buzz surrounding Apple's soon-to-be-available iPhone to news about a new low for the Japanese yen, you'll get **essential information to prepare you for the business day ahead**—and keep you ahead of the curve as the day goes on. And if you want to check out the full story, it's only a click away. An early edition of the summary is posted every weekday by 6 a.m. U.S. East Coast time, with an afternoon update available by 3 p.m. To check out our Executive Summary, go to businessweek.com/executivesummary.

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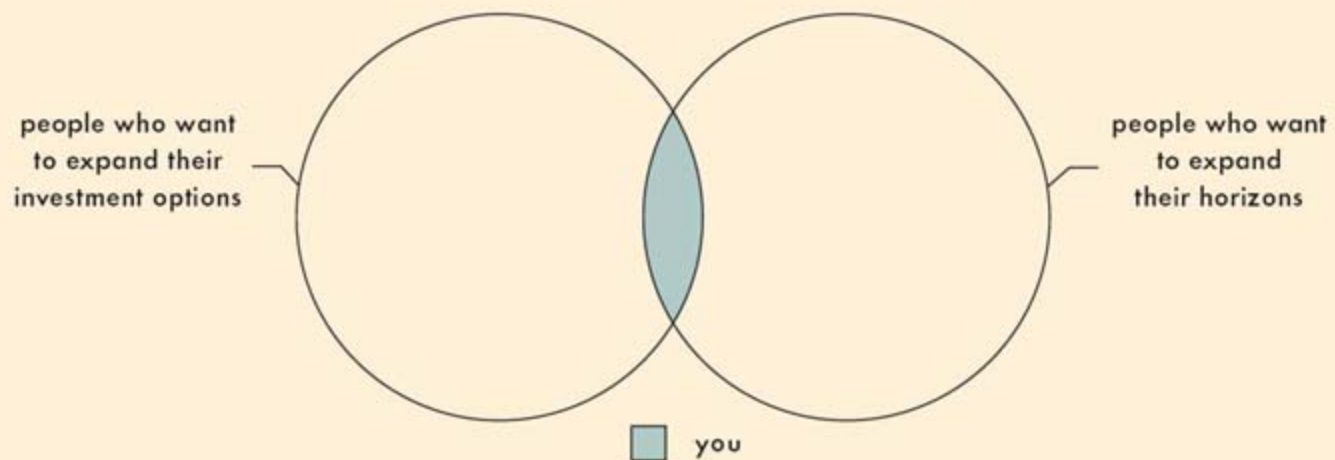
BusinessWeek weekend

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BROADENING PERSPECTIVES



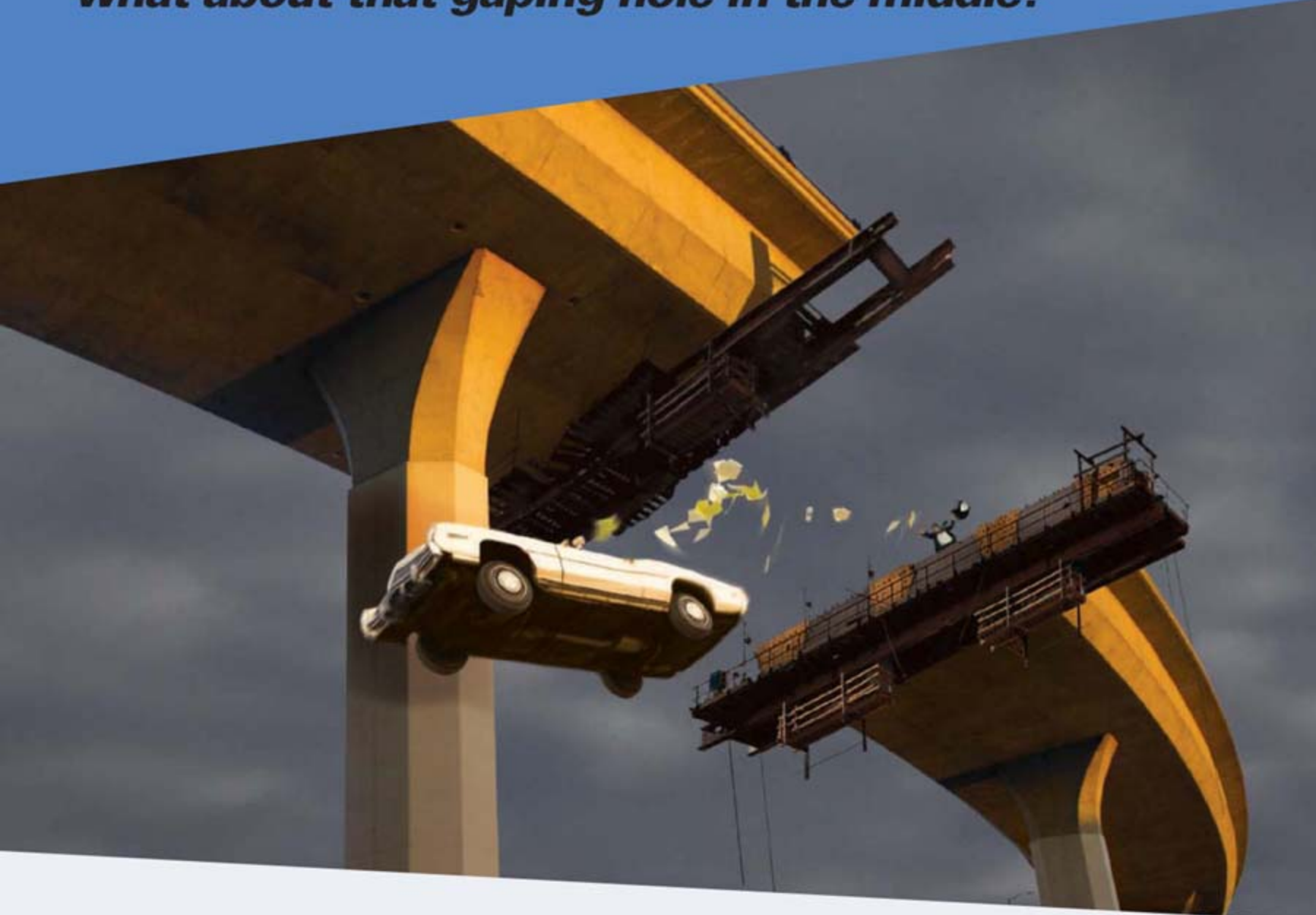
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“[It] is so far off the scale, it defies any attempts to make sense out of it.”

—David Menlow, president of research firm IPO Financial Network, on the bonanza awaiting Blackstone Group Chief Executive Stephen Schwarzman when the private equity firm goes public in the coming months, as reported by The Washington Post.

EDITED BY DEBORAH STEAD AND MICHAEL ARNDT

BUYER'S GUIDE

Five Things To Know About The iPhone



1

WHERE CAN I GET ONE?

The iPhone goes on sale at 6 p.m. on June 29 in AT&T (formerly Cingular) stores, Apple outlets, and the Apple.com Web site. If a store is sold out, you can still buy a phone (and select a plan) for later pickup or delivery. Officials at the companies believe it will be available to anyone who wants one by the end of July. Both AT&T and Apple are hiring additional staff to handle the early crush of sales. But as Apple has been training its store and telephone support staff since May to walk customers through the iPhone's many features, you may want to head there first. These folks, after all, will let you play with the gear.

2

WHO'S IT FOR?

The iPhone is being sold as an all-in-one replacement for your iPod, BlackBerry, and digital camera. Someday it may be just that. But \$499 is a lot to spend for only 4 gigabytes of memory. And don't forget the \$60 a month you may pay for service and a data plan. Such an expensive device should appeal to gadget lovers who want to connect to their corporate e-mail and other serious work applications, though typing may be awkward on the virtual keyboard. The phone allows you to grab personal e-mail from services such as Google and Yahoo!, but security issues may prompt big employers to prevent access to corporate accounts. Ask your IT folks if they have a plan. And there's no easy way to sync up with Microsoft Outlook e-mail.

3

SHOULD I WAIT UNTIL THEY WORK OUT THE KINKS?

There are sure to be glitches in this first version. The good news: Apple plans automatic updates you can download when you sync the phone with iTunes. Slow connection speeds will be mitigated by built-in Wi-Fi that lets you Web-surf at broadband hotspots.

4

WHAT IF I GET IT HOME AND DON'T LIKE IT?

AT&T usually offers 30-day, no-questions returns, but here it's deferring to Apple's 14-day return policy. Wireless service problems should be directed to AT&T; Apple will handle most hardware and software issues. Ask about warranty coverage; it is usually limited to 90 days and doesn't cover breakage. Apple sells extended warranties.

5

HOW'S IT COMPARE WITH OTHER HIGH-END PHONES?

The upside: The iPhone's "multi-touch" screen is simplicity itself, ditching mechanical buttons to free up screen space. The display adjusts to save power. The downside: iPhone is locked in to AT&T's network. Roaming fees can pile up if you're on other GSM networks, such as Rogers Wireless in Canada and Orange in Europe. You may not get a data connection everywhere. And the battery isn't replaceable, so keep a charger handy.

—Cliff Edwards

BusinessWeek weekend

TELEVISION For more on buying an iPhone, watch *BusinessWeek Weekend*. To see video clips or find local listings by Zip Code, go to businessweekweekend.com.

REWIND

ROADBLOCKS AHEAD FOR INVESTORS?

AS BRIDGES, roads, and other parts of America's infrastructure are increasingly privatized, they've become a hot commodity on Wall Street (BW—May 7). Now some Democrats on the Hill are trying to check the trend, in which investors pay into the

billions for leases on assets like the Chicago Skyway or the Indiana Toll Road in exchange for the cash flows from tolls and other user fees.

On June 4, two key Democrats on the House Transportation & Infrastructure Committee issued a report asserting that such public-private transportation partnerships "can supplement—but not provide a substitute for—public investments." Committee Chairman James Oberstar (D-Minn.) and



Representative Peter DeFazio (D-Ore.) called on states to protect the public from price gouging and ensure that state revenues garnered from such deals are used solely for transportation. They also want to shorten lease periods, which can run to 99 years.

Experts estimate that \$100 billion worth of public

property could change hands in the next two years. But the Democrats' stance—backed by the trucking industry, which fears rising tolls—could be a political roadblock for investors like Goldman Sachs, which has raised a multibillion-dollar infrastructure fund to pursue such deals. —Eamon Javers

SKILL-BUILDING



THE GAMES MANAGERS PLAY

THAT COLLEAGUE who sneaks online to play games during work just might be your boss someday. According to a new study by IBM, some multiplayer games teach skills needed to manage a modern multinational.

The computer giant hired software maker Seriousity to watch people play hundreds of hours of games where leadership is required. IBM also surveyed more than 200 players among its own managers. The finding: Those immersed in online worlds linking millions of participants, such as World of Warcraft, get good at gathering information from

far-flung sources, assessing risk, and moving quickly to the next challenge. IBM says the study, to be released on June 15, shows such games could be "management flight simulators" for those trying to lead global teams.

IBM has good reason to stress the positives of online gaming. It has been fashioning itself as the go-to consultant for businesses considering using games, with more than 250 clients. Come September, it will launch its own game for companies, Innov8, which lets players test their hands at, say, redesigning a call center. And you thought golf was the way to get ahead. —Aili McConnon

SPORTING PLASTIC

TAKE ME OUT WITH A GIFT CARD

THIS FATHER'S DAY, Major League Baseball is hoping the kids skip ties and tools for plastic. Teaming up with gift-card titan Blackhawk Network, baseball is marketing \$25 and \$50 cards to be used toward tickets, merchandise, and concessions.

Blackhawk, a unit of Safeway, already distributes gift cards for Visa and more than 225 retail brands, including Macy's, Best Buy, and Starbucks. Problem is, sales are seasonal: More than 40% come in November and December. (The gift card industry as a whole gets about 30% of its sales in the holiday months, according to Mercator Advisory Group.) Cards for pro sports could spread out those sales, says Jim Strabo, vice-president for Blackhawk's sports initiative.

Blackhawk offers an MLB card that can be used leaguewide. It has also struck deals with the NBA, NFL, NHL, and Major League Soccer, expecting a majority of teams in each—except the newest, MLS—to sell cards by yearend.

Available through team Web sites and retailers, and redeemable online or

at games, the cards can double as a marketing tool. The San Francisco Giants gives them to season ticket holders and groups and may use them as vouchers for rained-out games. Ken Logan, the Giants' IT director, says 2006 gift card sales topped \$1 million. The cards, he says, are "a great opportunity to get the brand buzzing all year round."

—Elizabeth Woyke





Jeff Weinstein
Founder and CEO,
The Counter Restaurants
Custom built burgers

Ask Jeff Weinstein Why He Loves His BlackBerry

"The Counter offers over 300,000 burger combinations. I've seen people put some pretty crazy toppings on their burgers and that's fine with me. We're moving into an age of customization. That's what inspired The Counter Restaurants. It's like my BlackBerry.[®] I can set it up how I want. It really is all about the individual. And as our restaurant concept expands nationally, my BlackBerry is helping me build my business on my own terms."

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BlackBerry

FOODSTUFF O.K. KIDS, NAME THAT CHIP

NACHO CHEESE, Cool Ranch... X-13D? The mysterious name is on packages of the latest flavor of Doritos, which hit stores last month. Following its user-created Super Bowl ads earlier this year, Doritos is asking consumers to name the new product—which tastes a bit like a mayo-sauced cheeseburger—by submitting suggestions on the Web.

The promotion is all about enticing teenagers and spreading Dorito buzz online,



says Ann Mukherjee, vice-president for marketing at Frito-Lay. To spark curiosity, Doritos sold the black bags of chips on eBay two weeks ahead of shipping them to stores.

With 100,000 suggestions so far (Cheeseburgeritos, anyone?), Doritos says it hasn't decided whether it will use any of them—or even if it will re-release the flavor after the 5 million-bag shipment sells out. Sparking consumer involvement is the point, says Mukherjee.

It's savvy marketing, says Jeff Jaffe, president of consultancy Crayon. "This partners with the consumer," he says, "and puts the product front-and-center as the hero."

—Burt Helm

BLOGSPOTTING CHINA SYNDROME benross.net/wordpress

» **BENJAMIN ROSS** of Kansas City went to China in 2004 to teach English and stayed to immerse himself in Chinese life. His blog—sprawling as the southeastern province of Fujian, where he lives—gives a real feel for what has and hasn't changed in China. From his perch at the barber shop where he's a trainee (a monthlong gig), Ross, who also writes for online journal Orbus Investor, delivers some keen insights on China's working class.

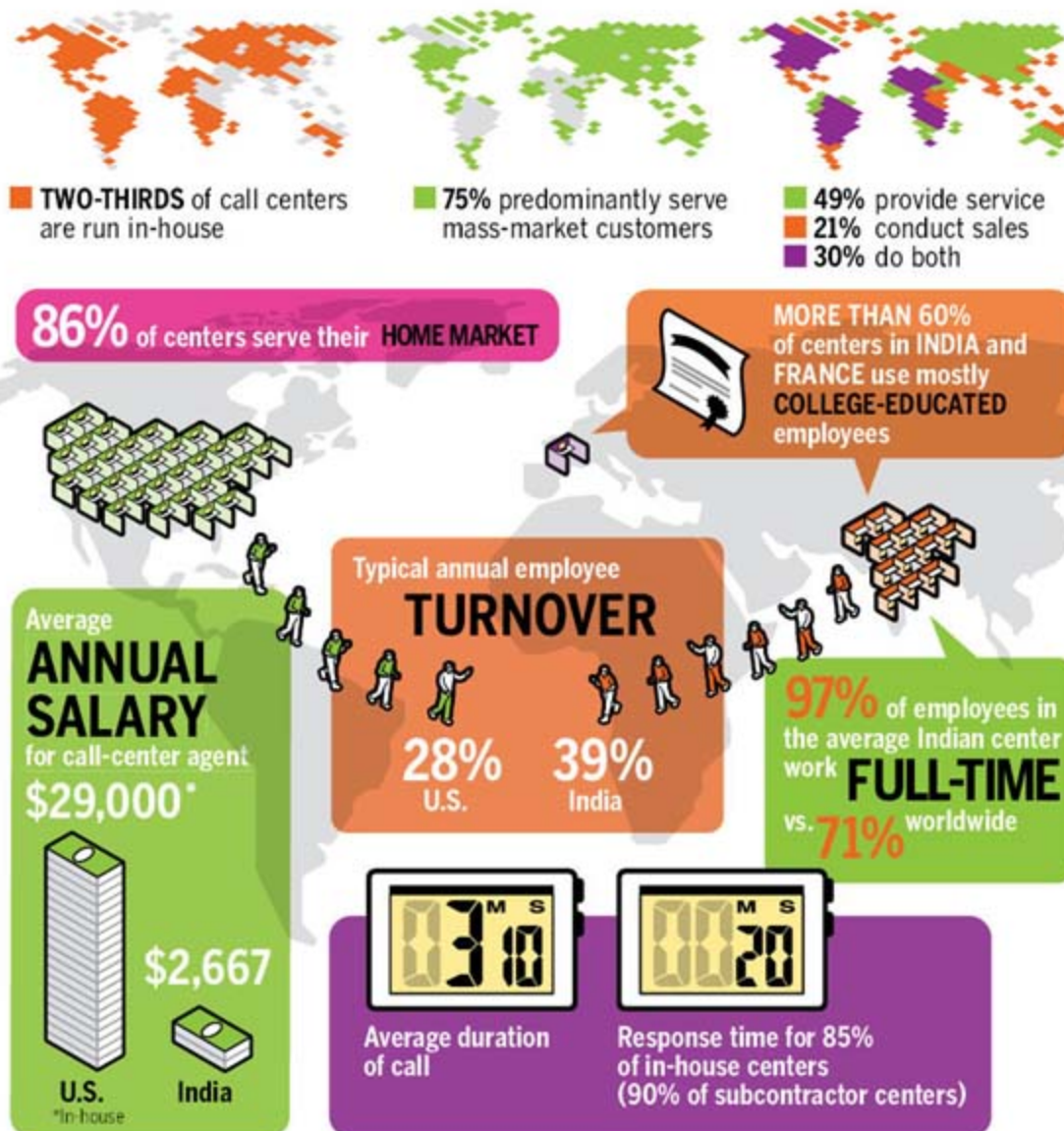
—Kristen Lease

OUTSOURCING HELLO, INDIA? ER, DES MOINES?

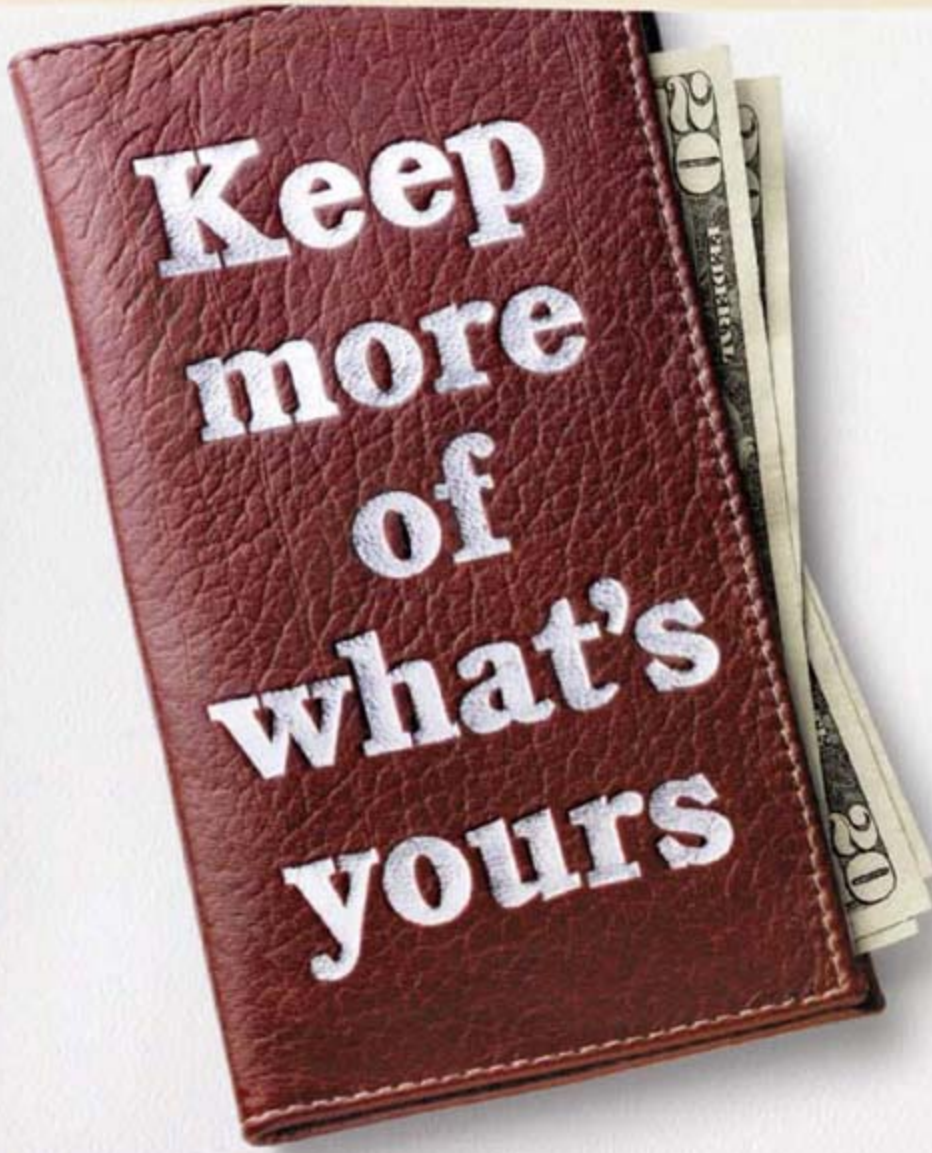
MOST CALL CENTERS catering to American customers are in the U.S., not overseas, contrary to what many people may think. That's just one finding in a new study—the largest ever—of 2,500 call centers in 17 countries.

Led by Cornell University, the survey shows that most call centers serve their own domestic markets. India is an obvious exception, with 73% serving foreigners. (Indian centers also average 741 employees, compared with 96 to 396 in the U.S., depending on the sector.) "The kinds of calls that are going offshore continue to be very simple transactions," says Rosemary Batt, professor of human resource studies at Cornell and a lead author of the report.

Here's a sampling of what else the researchers found about the world on the other end of the line. —Kerry Miller



Data: *The Global Center Report*, Cornell University, University of Sheffield, Britain; Working Life Research Center, Austria. Countries participating in survey: Austria, Brazil, Canada, Denmark, France, Germany, India, Ireland, Israel, Netherlands, Poland, South Africa, South Korea, Spain, Sweden, Britain, and the U.S.



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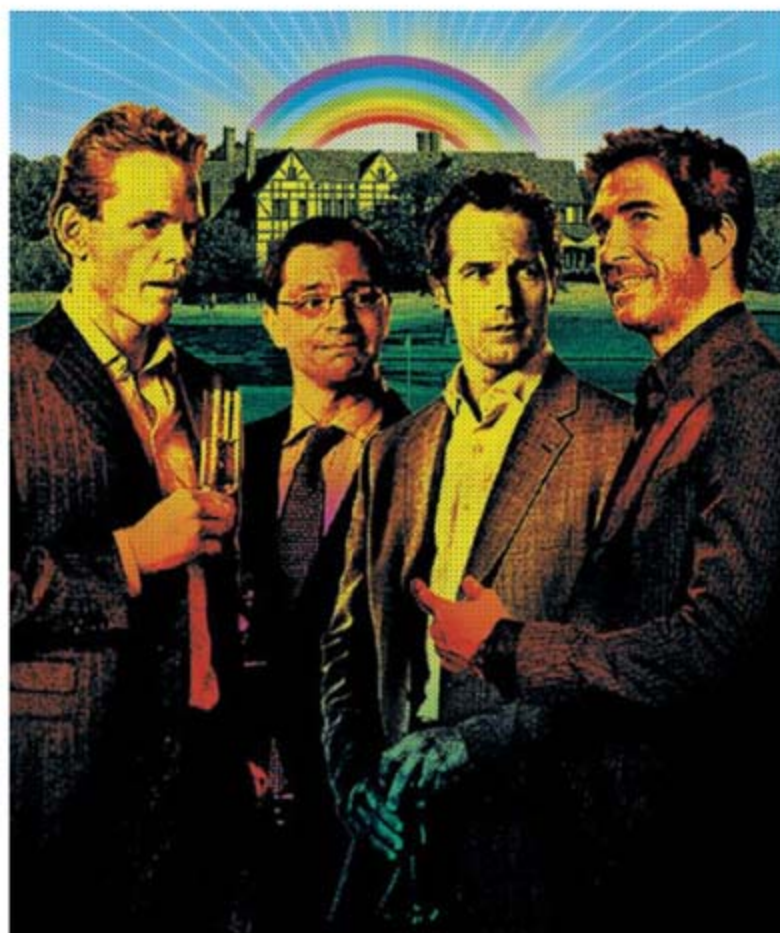
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TV GUIDE

HOT YOUNG CEOs WITH TIME TO BURN?

AMERICANS CAN'T get enough TV shows about cops and docs. Suits are another matter. *The Street*, a stock-trader drama, was canceled after 12 episodes on Fox in 2001. Still, ABC will try the corporate setting with this fall's *Big Shots*, an hour-long drama series—airing on Thursday nights after the popular *Grey's Anatomy*—about the professional and personal problems of a quartet of CEOs.

Creator Jon Harmon Feldman, a writer and producer for *The Wonder Years* and *Dawson's Creek*, has the show's CEOs run outfits with real-enough names. James (Michael Vartan, formerly of *Alias*) heads up Amerimart, a thinly disguised Wal-Mart, and Duncan (Dylan McDermott, ex-star of *The Practice*) runs Reveal—think Revlon—Cosmetics. Then there's Karl (onetime *West Wing* actor Joshua



Malina): He's chief of Fidelity Pharmaceuticals, which, in one scene, has a problem with a Viagra shipment. The only CEO who's not at a giant corporation, Brody (comedian Christopher Titus), heads his own

consultancy, Alpha. "I thought it was great to not have to do another doctor or lawyer show," Feldman says. "I wanted to be 10 years ahead." (He may have competition sooner: Doug Ellin, who created HBO's

Entourage, is planning a series for the cable network about a hedge fund tycoon.)

Snippets of the show provided by ABC contain some dialogue that might pass for C-suite talk: murmurs about insider-trading charges in a crowd scene and a reference to Herb Allen's annual Sun Valley conference. Still, this is Hollywood. All the *Big Shots* are in their late 30s. (According to executive search firm Spencer Stuart, the median age of CEOs of S&P 500 companies hovers around 55.) And buff. Their fictional jobs allow enough gym time for them to look great lounging poolside at the country club they use as a refuge from work and wives. As they talk about their steamy personal lives, they occasionally morph into *Desperate Housewives*. (Charles McDougall, a *Desperate Housewives* director, did this show's pilot.) Feldman makes no apologies for taking liberties. "It's not a documentary," he says. "Is there a hospital with doctors who look like the cast of *Grey's Anatomy*?"

—Reena Jana

QUESTION OF THE WEEK

With Apple's feature-laden iPhone about to launch, we ask: What have mobile makers overlooked?

"The mobile carriers should open their networks so our phones can add software as easily as our PCs can."

—Esther Dyson, chairman, EDventure

"I'd like a subscription plan that provides a new phone every three months and recycles the old phone somehow—sort of a steak-of-the-month club for geeks."

—John Maeda, associate research director, MIT Media Lab

"I think a cool new function a phone should have is photo editing, so that you can give a photo some quick touch-ups."

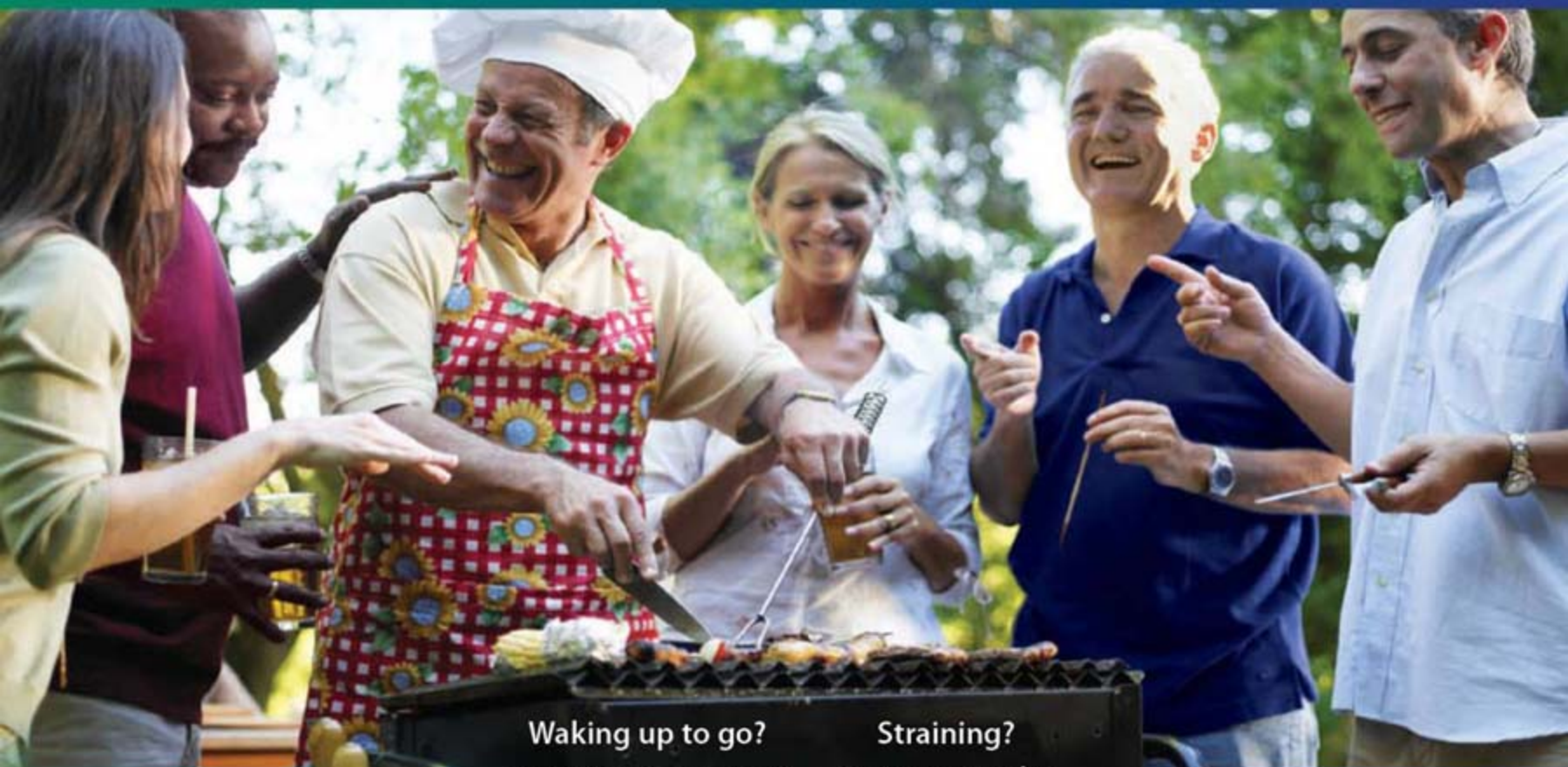
—Sean Zaccheo, 17, senior, Birmingham High School, Lake Balboa, Calif.



ILLUSTRATION BY SEAN MCCABE; (BOTTOM, LEFT) LISBETH KIRK

Want to spend more time grilling steaks, and less time on bathroom breaks?

FLOMAX may improve male urinary symptoms due to BPH in **1 WEEK**.



Waking up to go?
Stopping & starting?
Going often?

Straining?
Going urgently?
Weak stream?

Talk to your doctor. For many men, FLOMAX may help in one week.

FLOMAX is approved to treat male urinary symptoms due to BPH, also called enlarged prostate. Only your doctor can tell if your symptoms are due to BPH and not another condition such as prostate cancer. Common side effects are runny nose, dizziness and decrease in semen. A sudden decrease in blood pressure may occur upon standing, rarely resulting in fainting. So avoid situations where injury could result. If considering cataract surgery, tell your eye surgeon you've taken FLOMAX. **To learn more, call 866-432-9734 or visit 4FLOMAX.com.**

If you can't afford FLOMAX, our Patient Assistance Program may help. Call 800-556-8317.

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Please see Patient Information on adjacent page.

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IMPORTANT PATIENT INFORMATION

What is FLOMAX?

FLOMAX is a prescription medication that is specifically designed to help relieve the signs and symptoms of *benign prostatic hyperplasia (BPH)*, a condition your physician may refer to as an enlarged prostate. FLOMAX works by relaxing the prostate muscles around the urethra, allowing urine to flow more freely out of the bladder. FLOMAX is NOT indicated for the treatment of high blood pressure.

Who should not use FLOMAX?

You should not take FLOMAX if you are allergic to tamsulosin hydrochloride or any other component of FLOMAX.

What should I be aware of before taking FLOMAX?

- o An enlarged prostate (BPH) and cancer of the prostate cause many of the same symptoms. It is important that you see your doctor first to rule out prostate cancer.
- o Though extremely rare, FLOMAX and other drugs in this class (alpha-1 blockers) have been associated with prolonged painful erection (priapism), which is unrelieved by sex. If this occurs, seek immediate medical attention, since this condition can lead to permanent inability to have an erection, if left untreated.
- o During cataract surgery, a condition known as intraoperative floppy iris syndrome (IFIS) has been observed in patients treated with drugs in this class. When considering cataract surgery, inform your surgeon if you are taking or have taken FLOMAX and/or other drugs in this class.
- o If you have had a serious reaction to sulfa, be sure to tell your doctor before taking FLOMAX.
- o FLOMAX should NOT be used in combination with other drugs in its class since interactions may be expected.
- o FLOMAX should be used with caution in combination with cimetidine or with warfarin (a drug often prescribed under the brand name Coumadin[®] [Bristol-Myers Squibb Company]).

Are there any warnings associated with the use of FLOMAX?

FLOMAX may cause a sudden drop in blood pressure, especially following the first dose or when changing doses. Although rare, this drop in blood pressure may be associated with fainting, lightheadedness or dizziness. Caution should be

exercised when driving, operating machinery, or performing hazardous tasks, since injury could result.

What are the most common side effects of FLOMAX?

The most common side effects are dizziness, runny nose, and a decrease in semen. Other side effects include headache and tiredness.

How should I take FLOMAX?

FLOMAX 0.4 mg capsules are taken once daily. FLOMAX should be taken approximately one-half hour after the same meal each day. If you stop or forget to take FLOMAX for several days, start again with the 0.4 mg once-daily dose. If you were previously on a higher dose, contact your doctor before returning to the higher dose.

Do not crush, chew, or open FLOMAX capsules.

What about overdosing with FLOMAX?

You should always take your medications according to the directions given by your doctor. If you think you have taken an overdose of FLOMAX capsules, contact your doctor immediately.

Still have questions?

For more information, ask your doctor or pharmacist, call 1-866-432-9734, and/or visit www.4FLOMAX.com.

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“Mr. Mulally, if you want to know why you can’t hold on to your customers, give me a call.”

—David Cohen
 San Jose, Calif.



MULALLY WILL CHANGE FORD, BUT HAS HE ARRIVED TOO LATE?

THE UNITED AUTO Workers has been bleeding Ford dry the past 40 years (“The new heat on Ford,” *News & Insights*, June 4). Ford and other U.S. car-makers just lay back and took the path of least resistance, letting the American consumer pay both in high prices and poor quality. I got tired of it and really enjoy my Toyota 4Runner.

—John Lowe Jr.
 Cornelia, Ga.

I WISH ALAN MULALLY well in his quest to unbind Ford’s culture. It will take more than products to fix the company. Customer service and satisfaction will play a role as well. Over the past 20 years, I have owned or leased a collection of more than a dozen products from Ford and its various divisions, but no more. I just turned in a Lincoln and a Mercury, paying off their leases early and walking across the street to buy my next vehicles from a different manufacturer.

It is all because of a problem I had with one of those cars. It needed to be towed to a dealer and have a mechanical problem resolved. Because I was

one day out of warranty—one day—I was told that my problem was no longer Ford’s and that I would have to pay for the tow and the repair. After hours on the phone with their poorly named Customer Relationship Center and an extremely frustrating exchange of e-mails, I finally got them to agree to reimburse me for the towing, but that was as far as they would go.

I am now driving a vehicle from another manufacturer. That dealer corresponds regularly with me to check my level of satisfaction, jumps to attention when something needs to be fixed, and works aggressively to win my business. And by the way, more than two months later, I am still waiting for the reimbursement check from Ford.

Mr. Mulally, if you want to know why you can’t hold on to your customers, give me a call. I’m in the phonebook.

—David Cohen
 San Jose, Calif.

“THE BALKANIZED MESS” that is now Ford surely did not occur by accident or overnight. I wonder how many key management decisions and critical staff decisions were made by Ford based

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ReadersReport

on recommendations from management consultants.

—*Geoffrey D. Batrouney*
Executive Vice-President
Estee Marketing Group Inc.
New Rochelle, N.Y.

CALLING ALAN MULALLY an “ex-engineer” is like calling Bill Clinton an ex-President. Once you are an engineer you are always an engineer. Engineers know how to think and to make things happen. Ford is most fortunate to have a real engineer in charge as CEO and one who has demonstrated leadership and turnaround skills.

—*Ed T. Barron*
Washington

FORD IS A GRAND old American corporation that’s building some excellent products right now. If Mr. Mulally succeeds in blowing up its “deeply ingrained hierarchical culture,” certainly an anachronism in today’s brutally competitive automobile industry, it will become a stronger and more innovative company worldwide.

—*Robert E. Luce*
Riverside, Conn.

WRITER DAVID KILEY says “after...1961, Henry Ford II gradually assumed a bigger role in management.” In fact, Henry II assumed the biggest role in management in September, 1945, when he became president.

On May 11, 1946, he completed his recruitment of Ernest R. Breech to become Ford’s executive vice-president and chief operating officer—and Henry II’s mentor. Ignoring Breech’s critical role in the postwar “rebirth” of Ford, even in passing, was a serious slip.

—*Peter Whittier*
Dade City, Fla.

MBA COACHES KNOW WHERE THE ETHICAL LINES ARE DRAWN

AS AN MBA admissions coach based in Monterrey, Mexico, I can attest that ethical MBA advisers do not write applications for clients (“It’s almost like...admitting an impostor,” B-Schools, June 4). They coach them on personal salesmanship, a skill students need well beyond business school and one not usually taught in Latin American universities.

—*Garza García*
Nuevo León, Mexico

DOUBTS ABOUT THE VALUE OF UNSKILLED IMMIGRANT LABOR

MICHAEL MANDEL’S commentary, “Globalization vs. immigration reform” (News & Insights, June 4), ignores the fact that the vast majority of our illegal immigrants have very little in the way of education and skills, with at least half not having graduated from high school. To the extent that there are public policy reasons for immigration, it would be of greater benefit to existing American citizens to select more educated and skilled immigrants as needed. On a per capita basis, the more educated and skilled would add much more to the economic output of the country, pay much more in taxes, and use a much smaller amount of public services than our typical illegal immigrants.

If we do not stop them, our poor illegal immigrants with limited education and all of their attendant costs can only greatly increase in number, so powerful are the incentives to come here. It is contradictory and nonsensical policy to make great and very costly efforts to eradicate poverty in this country and import much more poverty at the same time.

—*Peter A. Schulkin*
Cambria, Calif.



COULD MANDEL EXPLAIN why, in Japan, foreign workers are only 0.3% of the population of the country, and tell us whether he has read what was written in *BusinessWeek* in 1990 ("Why they call Japan 'Robot Paradise,'" *Science & Technology*, Aug. 20, 1990): "Labor shortages helped spur Japan's robo-mania. In the 1980s, Tokyo refused to let immigrants in to take up the slack, and Japan's giant builders turned to robot R&D. 'The labor shortage propelled these companies to the forefront of field robotics,' says Shigeaki Yanai, research manager at the Japan Robot Assn.

"Now, Japanese construction sites are a showcase of automation that U.S. contractors only dream of."

How does it come about that Japan has a free flow of goods and capital without a free flow of labor?

—Charles Carmagnol
Nice, France

I THINK THE REAL issue for immigration reform is rule of law not globalization. Bernie Ebbers and illegal immigrants have something in common: They don't obey the law. Now some

people want to change the law so the illegal immigrants are legal. Should we have changed GAAP (Generally Accepted Accounting Principles) so Bernie Ebbers was legal?

Mandel also mentions IBM as a great example of globalization, which it is. The question I have is: "How many illegal immigrants does IBM employ?"

—William Thayer
San Diego

LEADERS SHOULD NEVER—EVER—PLAY THE BLAME GAME

WHEN SHOULD A LEADER pass blame? Jack and Suzy Welch (*The Welch Way*, June 4) correctly point out that leaders own all outcomes, good and bad. But then they allow leaders one exception. Leaders, it seems, get a pass when they can blame rogue employees. I'm sorry. Rogue employees must be held accountable, but the most effective leaders share the credit and hoard the blame. The first instinct of the best leaders is to fix the problem rather than to fix the blame. Letting go of blaming behaviors is a basic business decency that doesn't cost an executive a dime

yet rewards the leader with followers who are willing to take risks and who are a little less reluctant to own up to those mistakes when they happen. In such ways, decencies build the corporate cultures we desire. Blaming gets leaders nowhere.

—Steve Harrison
Chairman
Lee Hecht Harrison
Woodcliff Lake, N.J.

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Streaming Video to Go

I've grown very fond of YouTube, from the stupid Mentos-in-Diet-Coke stunts to the clips of classic Sid Caesar-Imogene Coca comedy skits. But videos from YouTube and all other streaming media sites on the Web have one big disadvantage: For all but the very tech savvy, it's difficult to download them or take them with you on the road.

RealNetworks has the best solution I have seen so far. The latest version of RealPlayer, which will be available for free download by the end of June, lets you record any streaming video available on the Web that is not copy-protected and save it for offline viewing. You can even download some of the content to many handheld devices, although this is harder than it ought to be.

Like its predecessors, RealPlayer 11 (Windows only, for the time being) manages and plays music and videos and provides access to Real's music store and Rhapsody subscription service.

The difference comes when you play a streaming video in Internet Explorer or Firefox. A button labeled "Download this video" appears in the browser. Click it, and a copy is recorded to your hard drive. Once it is downloaded, you can watch it when you are offline, burn it to a CD or DVD, or copy it to another device. The recorder can handle the popular streaming-video formats: Adobe Flash, Microsoft Windows Media, Apple QuickTime, and RealMedia.

RECORDING STREAMING VIDEO isn't new, but until now only people with the skill and inclination to find and install obscure programs could do it. RealPlayer 11 lets anyone record streaming video at the click of a button. Some content owners, whom Real CEO Rob Glaser calls the "Flat Earth society," are unhappy about making recording easy for consumers, but none have publicly threatened any action.

In any event, RealPlayer makes efforts to respect the rights of content owners. If, for example, you try to snag copy-protected content, such as an episode of *CSI* from cbs.com, you get a message saying the video cannot be downloaded. RealPlayer also will include any commercials tacked on to the beginning or end of clips. There is one glitch to this, however. If the ad is an integral part of the video, both will be recorded. But if it is a separate file, and you click "record," you'll save only the ad. To get the main video, you have to click again once it starts playing.



**RealPlayer
will let you
record clips
for offline
viewing**

What's annoying about these downloads is that they often turn into files on your hard drive with names that don't reveal their content. For example, every clip you record from comedycentral.com gets a name that tells you only that it came from Comedy Central. You have to change the names, or you'll never remember that the clip is Jon Stewart on *The Daily Show* goofing on candidate debates. Real should ask you to name the clip as the download starts. (YouTube videos usually have relevant names.)

It would also be great if RealNetworks made it easier to watch the video clips that you have synced to a handheld device. Handhelds can play anything recorded in Flash format, which fortunately covers most popular sites such as YouTube. But first you have to download special

software for your Windows Mobile or Palm device. Getting the clips to work on an iPod is far more trouble; most people will conclude that they're better off sticking with what Apple offers at the iTunes Store, even if they have to pay for it.

Overall, though, my quibbles with the new RealPlayer are minor. It's worth it just to be able to pop open my laptop, even on a plane, and have Monty Python's "Dead Parrot" or "The Dirty Hungarian Phrasebook" ready to cheer me up. ■

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Not Bad, for a TV Network

A few years ago someone called a friend of mine “the prettiest blogger.” This, she noted, is rather like being called “the tallest short person.” The same may be true when it comes to picking the smartest TV company playing in the online world, but in this milieu the tallest short person is CBS. ¶ Since mid-April it has inked partnerships with two dozen

partners—from Bebo to Veoh—to syndicate its programming online. (CBS will generally receive 90% of the ad revenue sold around its content.) It has bought interesting online players, both large (music-based social network last.fm for \$280 million) and small (daily financial video startup Wallstrip, for an undisclosed, much tinier sum). CBS also passed on taking an equity stake in the still-unnamed Web-video site that NBC Universal and News Corp. are assembling, because that would mean exclusively syndicating shows with the venture. That stake “might be huge down the road,” concedes CBS CEO Leslie Moonves. But he says the point of CBS’s current moves is not to have one big property with “an equity upside 10 years from now.” Instead, CBS wants money coming in from myriad directions, so that if future critics say, “‘Gee, your primary source of revenue isn’t as high as it once was,’ we can say ‘That may be true. But we have 30 other sources that make the absolute gain significantly bigger.’”

EVEN IF CBS HAS BET CORRECTLY, it’s still a big stretch to think all will turn out that neatly. But such thinking, and the attendant deals—thanks to the team led by fast-talking Quincy Smith, CBS’s yearling president for interactive efforts—have led CBS into legitimately interesting territory for a multibillion-dollar media company. The ethos online—true even if clichéd—is being willing to give up control, and CBS is on the far end of the bell curve when it comes to indulging fans who want to play with its programming. All networks at this year’s upfront presentations lunged desperately to show they were down with the cool kids online. CBS flaunted a YouTube video that strung together a montage of *CSI* star David Caruso’s monumentally portentous one-liners. “Mash-ups—I look at 99% of them as a great promotional tool,” says Moonves. Mash-ups and mix tapes (or CDs) are crucial for introducing fans to new voices in hip-hop, to cite one example. But you would have a hard time finding a music executive in Moonves’ position who would say that.



Not long ago, the shining hope for TV was that “on-demand world” meant “people buying programs.” In October, 2005, ABC first sold full-length programs on iTunes and won kudos as paid downloads ticked into the millions. But a few million sales at \$1.99 per are barely felt at a company grinding out revenue by the billions, and in 2007 CBS espouses a nuanced view. “Three-fourths of our business” is ad-supported, says Smith. “We’ll stick to what we know.” So ubiquity trumps pay-per-download. Which makes sense both for a company that gets most revenues from a free-programming model and for today’s environment. Web surfers want to get free stuff, not buy what’s free elsewhere. (Although there’s no downside in selling shows on iTunes, as CBS still does.)

CBS’s online strategy is to go with what it knows: ad-based revenue

Smith also openly muses about the limits of streaming full-length TV programs: “It’s arrogant for me to assume that regurgitated content is what’s going to work on the Web.” This leads him to the likes of Wallstrip. And to last.fm, which built a thriving social network around users recommending music, which could have big implications for CBS’s TV and radio assets. All this could end in tears, obviously, and is so new that there’s far more potential than profit. And all the Web wisdom in the world won’t help CBS if the hits dry up. But CBS’s moves are coherent philosophically, and about as in tune with how people behave online as one may expect a traditional company to be. Whether its competitors are teeny or titans, CBS can still walk tall. ■

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BY JAMES C. COOPER

Interest Rates Are Up, But Are They High Enough?

Financial conditions may still be too lax to keep inflation under wraps

U.S. ECONOMY

Ever since the Federal Reserve stopped raising interest rates, about this time last year, Fed policymakers have had an easy go of it. They only needed to sit back and wait for past rate hikes to slow the economy and relieve pressure on inflation. Everything was going well until a couple of weeks ago, when it became evident the

economy was picking up again—and with no real assurance yet that any steam under prices had been vented. Consequently, bond yields have soared as investors have given up hopes that the Fed will cut rates, especially as central banks overseas continue to bump up rates amid signs the global economy is booming.

All this signals that the policy road ahead is going to get a lot rockier. For the first time in a year investors are starting to weigh the chance that the Fed may have to lift interest rates, perhaps later this year. Much depends on one key question: Just how tight is monetary policy right now, not only in the U.S. but overseas? And is it tight enough? The surprising resilience of the U.S. economy this quarter and the continuing strength abroad suggest financial conditions around the world are still too loose to assure inflation stays under control.

TO SOME EXTENT, THE RISE in bond yields, to a five-year high of 5.29% on June 12 for the 10-year Treasury note, helps the Fed with its anti-inflation work. However, most of that jump will be felt in housing activity, which is not where the Fed would like to see more rate pressure. As of June 12 the national average of 30-year fixed rates stood at 6.87%, up from 6.39% in May, according to HSH Associates. Still, that's not a big move, and with job markets strong and household wealth at record levels, prime mortgage borrowers will not be deterred by that small rise. The subprime bubble has already burst, and most of the damage there has been done.

The rise in bond yields adds only a smidgen of new constraint to the rest of the economy. The current level is far from alarming (page 38), and overall financial conditions remain favorable.

For example, although the stock market has recoiled in recent days, as of June 12 stock prices measured by the broad Dow Jones Wilshire 5000, the best gauge of household stock wealth, are still up 4.7% for the second quarter and 5.8% for the year. In addition, yield spreads between riskless Treasuries and riskier corporate bonds remain narrow, a sign that credit is flowing freely. Measures of bank-lending standards for corporate loans and nonmortgage consumer loans are

still accommodative. Also, the lower dollar is making U.S. assets more attractive to foreigners.

The Fed faces a tricky dilemma. It's beginning to look as if the economy could use two separate monetary policies, one for a sagging housing sector and one for everything else. The Fed's current target rate, at 5.25%, seems right for allowing housing to regain its footing slowly. But it may be too stimulative for the rest of the economy. The problem is that higher rates could push housing even deeper into recession.

Consider that growth in U.S. domestic demand, which includes imports but excludes exports and the ups and downs in inventories, has slowed to a yearly pace of only 2%, from a 3.7% clip this time last year. But housing has accounted for almost all of that drop-off. The other 95% of domestic spending continues to grow in the same 3%-to-3.5% range of the past two years (chart). This quarter, even including housing, economists are upping their forecasts for overall economic growth to 3% or better, and a few believe it could go as high as 4%.

At the same time, growth overseas is on a tear—a trend the Fed has no control over, and one that is helping to stimulate U.S. growth as exports soar. Central banks from the euro zone and Britain to Canada and the Pacific Rim are lifting rates in an effort to preempt inflation, and analysts agree they have more work to do.

BY ONE KEY MEASURE, monetary policies around the globe don't look restrictive at all: the central banks' real policy rates—that is, the target rate adjusted for inflation. The Fed's real target rate, currently close to 3%, is about half a percentage point above its long-run average, but in past periods of Fed tightening, it has gone much higher.

The real rate in Britain is close to that in the U.S., while

WEAK HOUSING HIDES BROADER STRENGTH



Data: Bureau of Economic Analysis, Global Insight Inc.

in the euro zone, Canada, and Japan, real policy rates are even lower. Central banks have been lifting interest rates, largely in an effort to get them back to normal levels after pushing them to abnormally low depths during the global deflation scare in 2003-04. Historically, policy rates are generally not up to levels that would indicate outright restraint against the forces of growth.

TO A GREAT EXTENT, past low interest rates are still working against the Fed's efforts to assure a noninflationary growth rate for the U.S. Those effects show up in how low rates, both at home and abroad, have buoyed a wide range of asset values, from corporate equity to home prices. The net worth—assets minus liabilities—of both households and corporations each rose to record levels in the first quarter, based on the Federal Reserve's latest accounting.

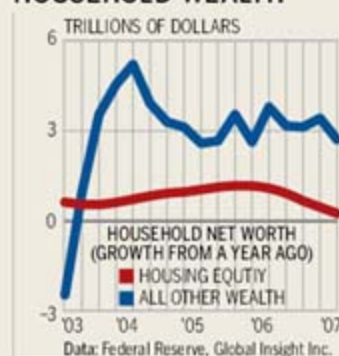
American corporations remain in exceptionally strong financial shape, and over the years they have reduced their exposure to spikes in interest rates. Since 2000, businesses have increased their share of fixed-rate long-term debt, from 61% back then to 73% in the first quarter of 2007, and overall debt as a share of net worth, while up marginally in the past two quarters, remains at low levels not seen in two decades.

Companies in the first quarter also had a gusher of cash flow, totaling \$1.1 trillion, which was sufficient to finance all of their capital spending. And much of recent corporate borrowing has gone to buy back stock. Net corporate equity has dropped by \$1 trillion over the past two years.

U.S. households are in good fettle financially, despite

dire headlines about high debt, low savings, and weak home prices. Look at May retail sales: Despite the bite from \$3-a-gallon gas, they blew away expectations, rising 1.4% from April, the biggest gain since January, 2006. And the gains were broad, not just confined to higher pump prices pushing up receipts at gas stations.

WHAT'S DRIVING HOUSEHOLD WEALTH



One reason consumer spending is so resilient is that household net worth rose to an all-time high of \$56.2 trillion by the end of the first quarter. Over the past year, household liabilities have soared by \$1 trillion, but assets are up \$3.9 trillion.

By the Fed's measure, homeowners' equity—home values minus

mortgages—has flattened out recently but is still up 2.1% from a year ago. Meanwhile, household financial assets, mainly stock market gains, are still lifting overall wealth (chart). Even with the latest pullback in stock prices, the boost to second-quarter net worth will be substantial.

So, investors beware: As long as overall financial conditions are as supportive of growth as they are now, both in the U.S. and overseas, there's a risk that the vigorous economy could fuel inflation somewhere down the road. Central bankers know the surest way to prevent that is higher interest rates. ■

EXPORTS

A Growing Appetite for U.S. Goods

THE GLOBAL economy is still running hot. Factories are using up available capacity, and labor markets are getting tighter. That means more capital and consumer spending abroad, which should translate into increased demand for U.S. goods and services.

According to calculations by *BusinessWeek*, global capacity utilization outside the U.S. continues to climb. An index made up of 33 countries, including Japan, Brazil, and those in the euro zone, but not India or China, continued to climb during the first quarter of 2007. Even including the weak performance of U.S. manufacturers in the past two quarters, the utilization rate

is still at levels not seen since 2000. Continuing strength abroad and a rebound among U.S. manufacturers will probably lift operating rates higher in the second half of the year, says JPMorgan Chase economist David Hensley.

Also, unemployment rates across the globe are falling as businesses hire workers to keep up with demand.

In April the Japanese jobless rate hit its lowest level since early 1998, while Canada's held at a 33-year low of 6.1%.

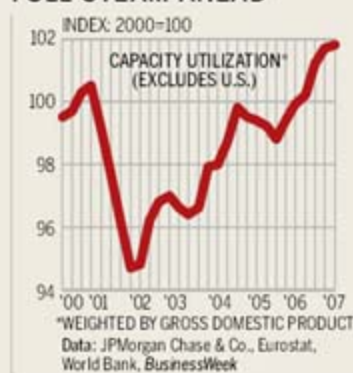
The combination of busier factories, tighter labor markets, and a weaker dollar will feed back into higher U.S. export and factory activity, says Hensley. The

need to expand capacity is fuel for makers of capital goods, which are more than a quarter of all exports. Plus, strong personal spending abroad has been a boon for producers of consumer goods, whose exports have grown at a double-digit rate (annualized) for six quarters in a row.

The small 0.2% rise in April exports followed a 2.6% surge in March, putting second-quarter exports on a high level. And in May the business activity reports from the Institute for Supply Management showed further improvement in demand from abroad. The ISM's index of foreign orders taken by nonmanufacturers hit a record high. If the global economy keeps rolling along, the rise in exports means that a smaller trade gap in 2007 could boost U.S. economic growth for the first time in over a decade. ■

—By James Mehring

GLOBAL MANUFACTURING: FULL STEAM AHEAD





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NEWS YOU NEED TO KNOW EDITED BY HARRY MAURER



BONDS GET WHACKED

Bond prices cratered and yields soared as investors finally concluded that the **Federal Reserve** was telling the truth about not wanting to cut short-term interest rates. On the market's worst day, June 12, the yield on the Treasury's benchmark 10-year note rose to 5.3%, a five-year peak. Stocks didn't take the higher rates well, with the recently surging Standard & Poor's 500-stock index dropping 3% in just over a week (photo, the Big Board floor).

Markets partially recovered on June 13. The 10-year yield, after touching 5.33%, receded to 5.2%, which helped the S&P to erase half its losses. Still, it's clear that Fed **Chairman Ben Bernanke** isn't about to cut rates with the U.S. economy perking up from its abysmal 0.6% annual rate of growth in the first quarter. The **Commerce Dept.** said retail sales in May rose 1.4%, double the gain analysts had predicted.

See "Bonds: Nothing to fear but fear itself," page 38

ONLINE "Stocks: Where to ride out the rate spike," businessweek.com/go/tbw

Immigration Reform Stalls

Even a personal plea from **President George W. Bush** failed to do the trick. At a rare closed-door meeting between the President and GOP senators on June 12, Bush pushed them to back the immigration reform bill that hit a roadblock on June 7. But he couldn't persuade conservative opponents to budge on an issue that business has been lobbying heavily to solve.

The Justices Speak

On June 11 the **Supreme Court** issued a flurry of decisions important to business. The justices sent a secondhand-smoke lawsuit back to Arkansas state court, foiling **Philip Morris'** bid to keep the case in federal court, often seen as friendlier to corporate defendants. The company faces claims in a potential class action that it misleadingly advertised the amount of tar and nicotine

smokers are exposed to from its "light" cigarettes. In other rulings, the court said home health-care workers aren't entitled to overtime pay under federal law, and that a company that voluntarily cleans up a **Superfund** site can pursue other parties to help cover the costs.

Hey, Want to Buy Jaguar?

The rumors have been swirling for months, and now they're

confirmed: **Ford** on June 12 said it's shopping its **Jaguar** and **Land Rover** brands. Jag has cost Ford more than \$10 billion in the 20 years it has owned the carmaker. Land Rover, acquired in 2000, has also lost money but is now profitable, Ford says.

ONLINE "Detroit's worst-kept secret"

businessweek.com/go/tbw

Executive Shuffle

Richard Notebaert, the man who revived telecom **Qwest** after a financial scandal, surprised analysts and dismayed investors by saying on June 11 that he'll step down as soon as a successor can be found. Across the Atlantic at **Airbus** parent **EADS**, **COO Jean-Paul Gut** quit after a dispute over management structure.

ONLINE "A telecom con-Qwest for private equity?"

businessweek.com/go/tbw

This Bid Wins a Gold

The players who have been chasing orthopedic-products maker **Biomet** proved as flexible as the company's spokeswoman, champion Olympic gymnast **Mary Lou Retton**. A consortium including **Blackstone Group** and **Kohlberg Kravis Roberts** first bid \$10.9 billion for the maker of replacement knees, hips, and other body parts. After Biomet demurred, the bidders jumped to \$11.4 billion, and on June 7 the board said O.K.

Trade Tremors

European Union Trade Commissioner Peter Mandelson told reporters on June 12 that "impatience and anger is going to rise" if China doesn't remove barriers to imports. The day before, China said its May trade surplus came to a little over \$22 billion—up 73% from a year earlier. On June 8 the U.S. reported a modest narrowing in its global trade deficit from

March to April, signaling that rising exports may help fuel growth this year.

Hear This, Mr. Semel

If you're making so much, why aren't we? That's the message Yahoo! shareholders sent to CEO **Terry Semel**. At the company's annual meeting on June 12, a third of stockholders, far more than usual, withheld votes from at least one of the company's directors. Semel has been criticized for his \$71.7 million pay package last year, when Yahoo stock fell 38%.

ONLINE "Yahoo's Semel faces the music"
businessweek.com/go/tbw

Big Banks Indicted

Italian prosecutors are out to expose the mechanisms of global finance that went awry in the 2003 bankruptcy of **Parmalat**, one of the greatest financial frauds in history. On June 13 a Milan judge indicted **Citigroup**, **UBS**, **Deutsche Bank**, and **Morgan Stanley** for failing to have procedures in place that would have detected the fraud. The banks, which advised Parmalat and issued bonds, deny wrongdoing. Their trial starts in January.

Browser Battle Royal?

A red-hot **Apple** is feeling mighty feisty. On June 11, CEO **Steve Jobs** said Apple will take on **Microsoft's Internet Explorer** with a **Windows-compatible** version of its **Safari** browser. Jobs also announced a plan to let developers write software for the upcoming **iPhone**. Could Apple become the king of smartphone software, a market Microsoft has targeted for years?

See "Five things to know about the iPhone," page 11

ONLINE "Apple reignites the browser wars"
businessweek.com/go/tbw

Block Those Phones!

Cell-phone chipmaker **Qualcomm** got a few more angry calls this week. The San Diego company is locked in a patent feud with rival **Broadcom**. On June 7, the U.S. **International Trade Commission** took **Broadcom's** side and banned the import of phones using the latest generation of **Qualcomm** chips, which could pose problems for companies like **Motorola**. **Qualcomm**, which denies wrongdoing, appealed to a federal court.

ONLINE "Banned: New phones with Qualcomm chips"
businessweek.com/go/tbw

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EMBARRASSMENT OF RICHES OF THE WEEK

Who'll be the big winners after the initial public offering for **Blackstone Group**? In a deal scheduled to hit the market the week of June 25, **Stephen Schwarzman** and **Peter Peterson** will earn the kind of mega-payout they could only have dreamed of when they co-founded the private equity firm some two decades ago with a \$400,000 investment. Schwarzman, 60, will walk away with about \$677 million and an equity stake of at least \$7.5 billion. Peterson, 81, gets nearly \$2 billion in cash and will own about \$1.6 billion worth. Of course, none of this means investors will necessarily get rich buying into Blackstone. At \$30 a share—the midpoint of the projected pricing range—the

firm will have a market value of \$32.4 billion. Shares will probably begin trading at a higher multiple than those of **Goldman Sachs**. That's a heady valuation for an outfit whose fortunes rest on the buyout boom going on and on.



SCHWARZMAN AND PETERSON

HOUSING

THE 'RE



FORECLOSURE SCUE' RACKET

As soon as a lender raises the red flag, scammers descend. Here's how they wind up holding the deed

BY DEAN FOUST AND BRIAN BURNSED

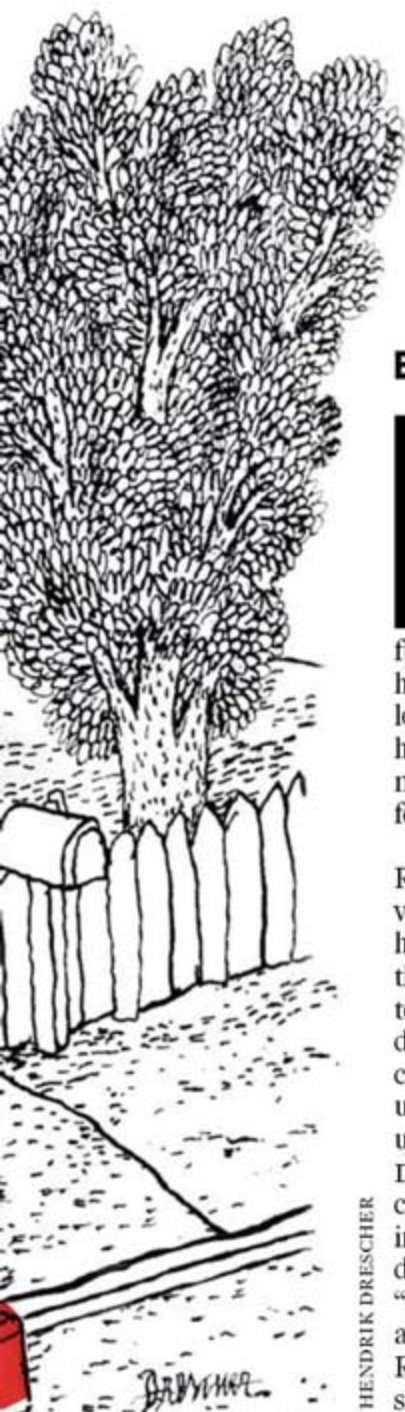
FOR DARRELL SA'LEY, THE PAST two years have been a case of bad to worse. After being diagnosed with cancer, the Virginia Beach (Va.) resident underwent two surgeries that put him out of work for more than a year—and months behind on his mortgage. Fearful he would lose his home, Sa'ley perked up when he heard a spot on a Christian radio station from a local firm, D&D Home Loans Corp., promising to help homeowners facing foreclosure and other financial crises. "All of the things that the ad was offering I really needed," the 37-year-old recalls.

After meeting with D&D owner W. Michael Robinson, who quoted from Scripture during the visit, Sa'ley signed a stack of documents for what he thought was an advance loan on a refinancing that Robinson had arranged with a private investor. Sa'ley now says he unwittingly signed over the deed to his home to Robinson's stepson, giving him claim to the \$230,000 in equity Sa'ley had built up over the years. "I felt as if the world had opened up and I was devoured," says Sa'ley, one of three D&D clients who has filed a civil suit against the company. Robinson says he had no financial interest in the deal and contends his stepson only took the deed after Sa'ley was unable to repay the advance. "I was more like a white knight who stepped up to assist someone, and now I'm being smeared," says Robinson, whose stepson has since given ownership of the home back to Sa'ley.

Situations like Sa'ley's are increasingly common. With the housing bust in full force and millions of homeowners facing foreclosure, the sketchier side of the real estate industry is coming into view. Although there are plenty of legitimate, mostly nonprofit, operations that help distressed homeowners, there's also a growing army of deceptive outfits that prey on and profit from this troubled group. While statistics on these schemes are hard to come by, law enforcement authorities confirm that foreclosure scams are rising sharply—so sharply that more than 10 states have recently enacted laws aimed at protecting homeowners.

MILLIONS OF TARGETS

IN MOST STATES, it's not illegal for one person to persuade another to sign his or her home over. And proving it was done through deceptive means can be tricky if the promises to help the owner were made verbally, as is often the case. So many victims have little recourse except through civil proceedings. But with the number of foreclosures estimated to soar to more than 2 million over the next couple of years, more and more policymakers are scrambling to keep the situation from turning into an epidemic by enacting tougher penalties for such practices. Massachusetts Governor Deval Patrick, a Democrat, filed legislation on June 11 that would criminalize abusive "foreclosure rescue" schemes. "In the coming months we're going to see a growing population that can be preyed upon by these schemes," says Massachusetts Attorney General Martha Coakley, who on June 1 added emergency provisions to the



HENDRIK DRESCHER

Foreclosure Solutions Group

Disclosure Statement Foreclosure Solutions Group (FSG)

FSG is not a credit or debt counselor but a foreclosure prevention specialist. Our goal is to assist distressed homeowners with preventing foreclosure and maintain or reestablishing ownership. FSG has not made and will not make any guarantees as to outcomes or results of its services and only agrees to use its best efforts in obtaining an alternative to foreclosure. **FSG is a private for profit company, whose ultimate goal and purpose is to acquire and invest in real estate.**

DISTRESSED HOMEOWNER

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state's consumer laws to prohibit foreclosure rescues in which the so-called rescuer profits from the transaction.

While the schemes vary in their mechanics, all follow a similar pattern. An individual or group, in the guise of helping a homeowner avoid losing his or her house, persuades the owner to transfer the title to the rescuer or another designated buyer. The practice has become easier with the rise of Web sites like PreForeclosure.com and All-foreclosure.com, which give subscribers listings as soon as mortgage lenders file a "notice of trustee sale" with the courts, the first step in the foreclosure process. Such sites, which compile public records to provide legitimate leads for investors in distressed properties, as well as services for homeowners, also give unscrupulous individuals direct access to potential targets.

BIRD DOGS CHASING EQUITY

WITHIN DAYS of showing up on such lists, desperate homeowners are beset by hordes of supposed white knights. Melissa A. Huelsman, a Seattle attorney specializing in bankruptcies and foreclosures, says that over the three months it typically takes a lender to foreclose, some of her clients receive as many as 20 calls or letters daily from firms promising to help them keep their houses. The outfits are sophisticated, carefully targeting owners whom the tax records show have been in their homes for years, a sign they may be sitting on a nice chunk of equity. "They know better than to go after homes refinanced or purchased last year [with subprime loans], because chances are it was a 100% loan and there's no equity to strip out," says Atlanta attorney Michael P. Froman.

Most commonly, the rescuers then coordinate what they say is a refinancing

through a designated investor, or they arrange a deed transfer with a rent-to-own plan that will supposedly allow the owners to buy back their homes down the road. But usually buried within the stack of closing documents is a so-called quit claim, or deed of gift, in which the homeowners effectively sign their houses over to the investor. At that point, the rescuers charge the former owners rent high enough to ensure they can evict them and pocket the equity built up in the property.

Some of these operations are quite complex. A number of firms recruit staff through real estate seminars or late-night TV infomercials to work either as "door knockers," who pay visits to distressed homeowners, or as "bird dogs," who serve as fake buyers. Take Real Estate Investor's Advantage (REIA), a Fort Washington (Md.) outfit run by Nathaniel X. Arnold that filed for bankruptcy and shut its doors last year. The firm's Web site advertised seminars in which attendees paid \$1,995 to become a "credit partner" in its "Real Estate Exchange & Profit System." In the pitch, REIA sought out individuals with good credit to be both door knockers and bird dogs in these transactions. In return, they would be paid a flat fee or a cut of the profits. (Arnold's attorney did not return multiple calls from *BusinessWeek*.)

One of REIA's credit partners, Joe Napolitano, knocked on Robert and Ruth Bowie's front door two years ago when Ruth was on the phone trying to negoti-

SKETCHY OFFER

The Bowies were skeptical of the deal with FSG

ate a payment plan with their lender. The semi-retired couple was in jeopardy of losing their

three-bedroom ranch house in Laytonsville, Md., which they bought in 1971. After several refinancings, their payments had ballooned to \$2,800 on a \$375,000 mortgage, and medical problems put the Bowies four months behind. While they were initially skeptical of Napolitano's offer to buy the house for \$475,000 on behalf of Foreclosure Solutions Group, also controlled by REIA's Arnold, they thought the rent-to-own plan was the only way to save their home. So the Bowies consented to the sale. "They told us the house would be back in our name in six months," says Ruth Bowie.

It didn't work out that way. Instead, under the direction of FSG, Napolitano and his son-in-law took out a first and second mortgage totaling \$475,000; after paying off the Bowie's outstanding loan of \$364,000, FSG allegedly pocketed the remaining \$101,000 in proceeds. The Bowies were shocked to discover at the closing that their rent, as part of "lease-back" agreement, would be \$3,600. Although

Napolitano's lawyer, Alexander Gordon IV, says his client made \$5,000 to \$15,000, he argues that Napolitano was scammed by Arnold's outfit, since he was left holding the mortgage. "He understood that he was keeping people from being homeless," Gordon says.

Meanwhile, the Bowies have fought back, filing a civil suit in the Circuit Court for Montgomery County, Md., last year. A circuit court judge in October ordered

FSG to pay \$3.9 million to the Bowies for emotional distress, money they are unlikely to see because of the firm's bankruptcy. Arnold denies in court filings that his program violated Maryland's "foreclosure protection" laws, an issue that will be decided at trial. The Bowies, who still live in the home and hope to one day own it again, are now paying \$2,600 a month as part of a temporary settlement, in which Napolitano forks over an additional \$1,200. Says Robert Bowie: "This boy ain't going to make this mistake again."

—With Brian Grow in Atlanta and Coleman Cowan in Laytonsville, Md.



TAKEN Sa'lley's home went to the stepson of his "rescuer." It has since been given back

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DEFENSE

HIGH-TECH WEAPONS: A LOSS OF CONTROL?

The Pentagon may be ceding too much power to Boeing and other contractors

BY STANLEY HOLMES

AT THE CORE OF THE Bush Administration's campaign to transform the U.S. Army into a leaner, more technologically advanced fighting force is something known as Future Combat Systems. A vast computerized network, FCS would link soldiers and commanders to a galaxy of sensors, satellites, robots, drones, and armored vehicles, both manned and unmanned. While debate rages over the military's performance in Iraq, the five-year-old FCS has sparked concern about whether the Pentagon is too eager to surrender control over complex weapons to the companies that design and make them—in this case, to Boeing Co.

In a little-noticed report issued on June 7, the Government Accountability Office, the investigative arm of Congress, warned that Boeing's influence over FCS poses "significant risks to the Army's ability to provide oversight." Because of the program's complexity and cost, GAO auditors urged the Office of the Secretary of Defense to assume direct supervision. The projected bill for FCS through 2030 has already more than doubled, to \$230 billion. Boeing would receive an undetermined fraction of that. The estimated price tag has ballooned even as former military officials and other experts question whether the ambitious program can accomplish its goal of allowing U.S. forces to cut through the confusion of battle.

FCS "misunderstands the frailty of the technologies, the limitations of the sensors, what they can and can't and never see," says Winslow T. Wheeler, a former GAO auditor of military programs who now directs the Center for Defense Information, a private research group in Washington. U.S. Army and Boeing officials counter that FCS remains on track and that the Pentagon hasn't ceded too much influence to the company. "We think [FCS] is going to revolutionize how we conduct warfare," says Lieutenant General Stephen M. Speakes, who heads the program to outfit 15 combat brigades, or about 60,000 soldiers, with the innovative gear.

Former Defense Secretary Donald Rumsfeld took office in 2001 pledging to transform a plodding Cold War force to a smaller, more mobile fighting machine, based on technological superiority. Much of that agenda fizzled when Rumsfeld encountered stiff resistance from uniformed leaders and Congress to trimming spending for tanks, nuclear submarines, and other expensive weapon systems designed for a war with the Soviet Union. Rumsfeld was forced from office in December, 2006, when his strategy of occupying Iraq with a relatively spare force failed to quell the bloodshed there.

One element of the Rumsfeld transformation that has moved forward is FCS. The Pentagon in 2001 set as a goal a first-ever detection-and-communication network that would connect disparate Army units of armor, infantry, and aircraft, which traditionally have had trouble maintaining contact and pinpointing the



FCS would link soldiers to a network of satellites, robots, and drones



enemy in the proverbial fog of war. The daunting task would require the writing of 63 million lines of computer code, the most ever for a weapon system.

The Army quickly concluded that it lacked the technical capacity to manage the program, according to Speakes. Beyond the sheer complexity of FCS, the Pentagon had seen 38% of its civilian workforce eliminated from 1989 through 2002, with much of the reduction coming from the staff that oversees weapons purchases.

Boeing, the Chicago-based military and civilian aviation giant, underbid General Dynamics Corp. and Lockheed Martin Corp. to win the main development contract for FCS. Previously only a minor player in competing for Army contracts, Boeing hired as its main subcontractor Science Applications International Corp., based in San Diego. Acknowledging in

(TOP) MARK LAMBIE/EL PASO TIMES



INHARM'S WAY Robots (bottom right) will serve as a soldier's eyes and ears

2003 that it would rely on Boeing to handle supervisory chores normally done by Army officials, the Pentagon named the company "lead systems integrator," a new designation in the arcane world of military contracting, although one not unique to FCS. "It means there is really nobody [in the Pentagon] monitoring the performance of these government contracts," says Joshua I. Schwartz, co-director of George Washington University's government procurement law program.

From the contractor's point of view, the arrangement offers the opportunity to anticipate the Pentagon's buying proclivities. "Simply being in a strategy-shaping position offered the potential to have an unprecedented understanding about the needs of a rapidly evolving [Pentagon] customer and could enable the defense contractor to better target its

product and service offerings," industry analysts with Sanford C. Bernstein & Co. noted approvingly in a report earlier this year. Boeing doesn't break out its annual FCS revenue, but in 2006 that money stream combined with the company's space-related revenue to total \$11.9 billion. Boeing had overall revenue of \$61.5 billion and net income of \$2.2 billion.

WEIGHT PROBLEM

THE GAO AUDITORS observed in their June 7 report that Boeing's influence has already raised troubling questions. One example: Armored vehicles outfitted with FCS technology were supposed to be light enough to be transported by C-130 cargo planes built by Lockheed Martin. But under Boeing's supervision, plans have already shifted to make the vehicles heavier, leaving the C-17, a

plane built by Boeing, as the only aircraft capable of moving them. On another front, the Army's weapons-testing command has raised concerns about whether Boeing has been granted excessive influence over assuring that FCS works properly.

The program "is at wide variance from the best practices" for acquisition embodied in the policies of the Office of the Secretary of Defense, the GAO concluded.

Boeing and the Army's Speakes disagree. "The Army is extremely happy," the general says, referring to the FCS program and Boeing's role. He stresses that the company, despite its unusual role, still works for the Army, which set the initial requirements for FCS. On the question of

heavier vehicles and whose plane can transport them, Speakes says engineers are struggling to develop lighter, stronger armor. But it could take years to reduce the weight of FCS vehicles.

Dennis Muilenburg, Boeing's vice-president for Future Combat Systems, says the Army participates in supplier selection and that all subcontractor bidding is competitive. Acknowledging the problem with overweight vehicles, he, too, says engineers are trying to address it. Boeing, he adds, enforces a strict "firewall" separating contractors writing specifications for FCS from those bidding on hardware contracts. "We have a hardware exclusion," Muilenburg says of Boeing, meaning that his company is prohibited from competing for subcontract work. "The process we set up precisely ensures that [conflicts of interest] don't happen." Boeing's role as



OVERSIGHT

Speakes (right) on Capitol Hill with Senator John Warner

lead systems integrator and its compensation are appropriate for such an intricate program, he adds.

KIDDING THEMSELVES?

BOEING AND Science Applications stand to collect a total of \$20.77 billion from FCS development work over the coming years. Boeing is expected to make a lot more for managing manufacturing assignments. The company and the Army plan to produce the first elements of FCS next year. These include the initial version of the program's operating software, a tactical radio, and ground sensors for use in Iraq. Full production of FCS weapons isn't scheduled to start until 2013.

Speakes says the Army ultimately will get its money's worth: "What we are doing is giving the soldier the ability to see and operate through remote sensors and other technologies. We do understand the changing shape of war, and we will continue to evolve FCS to adapt to those changing requirements."

Wheeler, the former GAO auditor, says Speakes and his allies are kidding themselves. FCS "is an attempt to micromanage the battlefield to a degree that is physically and mentally impossible. It just misunderstands technology and warfare at a fundamental level."

Some former senior military officials agree. Paul K. Van Riper, a retired U.S.

Marine lieutenant general, says the Pentagon must first focus on post-Cold War challenges such as how to confront urban guerrilla fighting. "We don't understand insurgencies, and we don't know how to counter them," Van Riper says. "I would have no problem with the Army researching FCS concepts, but to put these hundreds of billions of dollars into it is a waste of time and money. We don't need it in the immediate future."

Some in Congress, meanwhile, have begun to signal hesitation about FCS. Without trying to halt the program, the House Armed Services Committee in May approved an authorization bill that would reduce FCS spending for fiscal 2008 by \$857 million, to \$2.85 billion. The committee expressed "serious concern" about the program draining the Army's future budget. The panel also inserted language in the measure instructing the Defense Dept. not to issue new contracts with corporations as lead systems integrators. The full House passed the bill, but the Senate restored some of the House cuts in its version of the legislation. The two bills now have to be reconciled.

However lawmakers resolve the current tangle, the Army has bet a big part of its future on FCS, and Boeing appears likely to continue to benefit. ■

AIRBORNE
An FCS
drone in
a combat
simulation



Killer Application Or Science Fiction?

The Army's Future Combat Systems has sparked controversy

WHAT IT IS

A computerized communications-and-detection network that would link soldiers, vehicles, and aircraft that normally have difficulty connecting in the thick of battle.

WHY THERE ARE QUESTIONS

Government auditors warn that lead contractor Boeing has too much influence over the program; some in Congress worry about a ballooning budget.

HOW MUCH IT COSTS

Up to \$230 billion over 27 years. So far, the Army has doled out \$8 billion to Boeing, Science Applications International, and other companies.

Data: Defense Dept., Government Accountability Office

A man with a backpack is climbing a large, dark rock formation. In the background, a white lighthouse with a black lantern room stands on a rocky island. The sky is filled with dramatic, dark clouds, and the water is turbulent with white foam.

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COMMENTARY

BY ROBEN FARZAD

Bonds: Nothing to Fear but Fear Itself

Why the sell-off is healthy—and higher rates may signal a stronger economy

SEAL THE WINDOWS. Stock up on bottled water, energy bars, and BlackBerry batteries. Be ready to kick off your \$250 wingtips and run for your lives. Prepare, Wall Street, for certain destruction at the hands of... 5% interest rates! That, anyway, has been the reaction of many to the violent sell-off in U.S. Treasury

bonds this month that has sent interest yields spiking. (When the demand for bonds fades and prices fall, their yields rise, and vice versa.) The yield on the benchmark 10-year note touched a five-year high of 5.33% on the morning of June 13, up from just 4.56% two months earlier.

To many cable-TV pundits and investment strategists, the rout is a harbinger of doom. Put in the proper context, however, it's anything but.

Conventional wisdom holds that higher rates endanger both investors and the broad economy. They mean greater borrowing costs for companies and consumers, threatening economic growth and profits. They signal expectations of rising inflation, which erodes the real returns on all investments. They make it more expensive for private equity firms to take on debt to buy out companies at big premiums, a practice that has buttressed the nearly five-year bull market for stocks. And at the most basic level, higher rates on "risk-free" Treasuries make riskier assets such as stocks and corporate bonds less appealing.

But Treasury yields are like Rorschachs, revealing more about the mindsets of their observers than any intrinsic certainty in themselves. One could just as easily argue that rising rates are a healthy symptom of a strengthening economy. After all, the post-September 11, post-Enron economic funk prompted the Fed to slash its target short-term interest rate to 1%, an emergency measure that pushed Treasury yields to just a hair above 3% in 2003. The recent uptick, say many yield watchers, was long overdue. We might even dare to welcome it.

For all the commotion over the worst bond market sell-off in four years, long-term rates are still low by recent historical standards. The 10-year Treasury yield hit a staggering 16% in 1981 and closed that decade at a still robust 8%. "During the '80s, investors would recoil every time we went below 8% or 7%," says Brian S. Wesbury, chief economist at First Trust Advisors in Lisle, Ill. "It was like, 'I'll never buy a bond for less than that.' Now it's the opposite: fear on the way up." Yet long-term rates have merely revisited their two-century average of 5.25%, according to Lehman Brothers Inc.

'WHAT WE HAD WAS TOO LOW'

THE JUNE SWOON follows a long stretch of ultralow rates. At 5.33%, the 10-year Treasury recently yielded slightly more than the Fed's target rate of 5.25%. Yet for the preceding year and a half it yielded far less, a rare situation that historically has been a sign of weak growth expectations if not looming recession. The realignment shows a return to normalcy. There's nothing bad about that. "The Treasury yield is roughly where it should be," says veteran economist Sung Won Sohn of Hanmi Bank in Los Angeles. "What we had was too low."

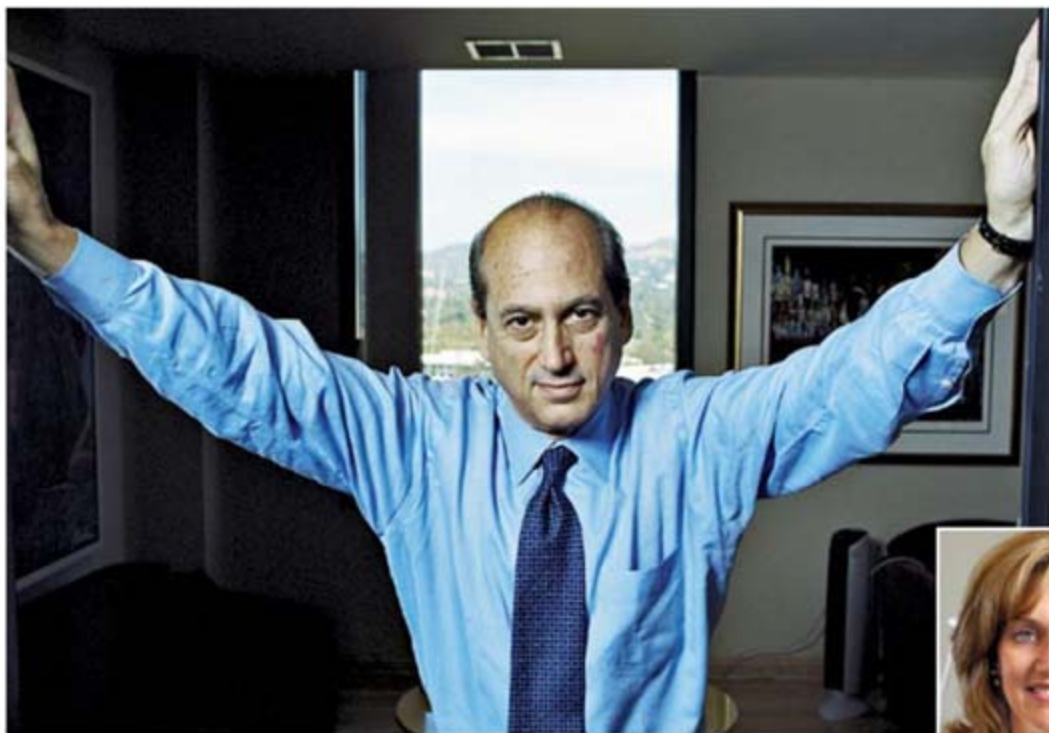
Higher interest rates also illustrate the strength of the global economy as new investment opportunities are making it tougher for foreign investors to justify parking funds in comparatively boring U.S. government debt. "Central banks are now beginning to toy with the idea of taking part of their reserves out of Treasuries and putting it into alternative investments," says David A. Rosenberg, North American economist for Merrill Lynch & Co. Even so, it's hard to imagine the cash-flush

Chinese forever avoiding Treasuries that yield 5.30% merely weeks after they were snapping them up at 4.50%.

Don't pronounce the private equity boom dead, either. Many big leveraged buyouts are actually financed with loans based on an interest rate set on a different continent: the London interbank-offered rate. Despite all the panic in the U.S. bond pits, that figure has held steady. Low rates there should keep money flowing into buyouts, underpinning the U.S. equities market.

This bond monster just isn't all that scary. ■





GOING NEGATIVE

Sitrick and Roehm could be counting on a media blitz to force Wal-Mart to the table



from here, look to Sitrick's work on behalf of former Hewlett-Packard Chairman Patricia Dunn, who was forced to resign in connection with HP's spying scandal. The parallels start with two women accused of wrongdoing by big opponents. "It doesn't take a lot of work to get Wal-Mart to come off as the bully," says Sitrick. "It's a clear David-and-Goliath situation. Julie is the underdog."

In Dunn's case, Sitrick was instrumental in working closely with her lawyers to give influential reporters—what Sitrick calls "lead steers"—access to Dunn. That resulted in profiles that allowed her to put forth her narrative, earning her more sympathy.

Experts say Wal-Mart, whose PR efforts have been known to backfire in the past, may be ill prepared for the coming onslaught. The Sitrick hiring was a surprise to Richard Edelman, whose eponymous PR firm Wal-Mart pays to run its war room in Bentonville. "That's unbelievable," he told *BusinessWeek*. "This is the heavy artillery." It doesn't help that Sitrick will use Wal-Mart's reputation against it. Says Dezenhall: "Wal-Mart's job is trying to convince people that Fay Wray was the real threat to King Kong."

Wal-Mart declined comment, but it has given no indication it will budge. The company has said it fired Roehm for carrying on an affair with a subordinate and accepting gifts from a potential business partner.

Roehm denies both. What's clear is that Roehm, who declined to comment for this story, made a poor cultural fit with Wal-Mart; she has conceded as much in the past. Yet Wal-Mart's hardball response has also confounded many. The company already faces image problems and slowing sales. "A sense of self-righteousness can blind you to a more prudent course of action," says Walter Montgomery, a partner at PR firm

Robinson Lerer & Montgomery. Luring top talent to Bentonville is already a challenge. A sideshow like this can't help but scare off other change agents. "This is a peanut," says Rubinstein. "But it's a peanut they could choke on." ■

SHOWDOWNS

OUT FOR BLOOD? WHO YOU GONNA CALL?

Julie Roehm hires attack machine Michael Sitrick, escalating her war with Wal-Mart

BY MICHELLE CONLIN
AND ROBERT BERNER

JULIE ROEHM'S LEGAL AND public-relations strategy may seem hyperaggressive. Besides suing Wal-Mart for wrongful termination, the former marketing star has accused its top officers of violating the company's conflict-of-interest rules. Now Roehm has hired Michael Sitrick, whose Los Angeles public-relations firm is known for going atomic on opponents, using "truth squads" (which dig up alleged inaccuracies in the media), "wheel-of-pain" tactics (negative publicity to quicken settlements), and high-profile journalists (who write profiles).

Roehm seems to be angling for a big payout. And if that means going negative with Sitrick's help, she appears willing to go there. Truth be told, it's probably the only option she has left. "They've already done as much as they can to try and destroy her career, so I don't know that she

has a whole lot to lose," says Paul Verbinen of Sard Verbinen, the crisis PR firm that advised Martha Stewart during her insider-trading case. Roehm's keeping the issue alive, adds Verbinen, means "Wal-Mart has more to lose."

Hiring Sitrick has all the classic elements of an unrelenting communications strategy constructed to support a lawsuit. Says legendary New York PR fixer Howard Rubinstein: "I've no doubt she hired him to tell her story in the most difficult, attacking method he knows." Adds crisis management expert Eric Dezenhall, who defends the oil industry: "What is clearly happening here is a premeditated strategy to make this as painful for Wal-Mart as possible so that they come to the table."

For clues as to where the story goes

Sitrick:
"It doesn't
take a lot of
work to get
Wal-Mart to
come off as
the bully"

BREAKTHROUGHS

ON THE BRINK OF ARTIFICIAL LIFE

Craig Venter says success is near, but critics blast efforts to patent synthetic organisms

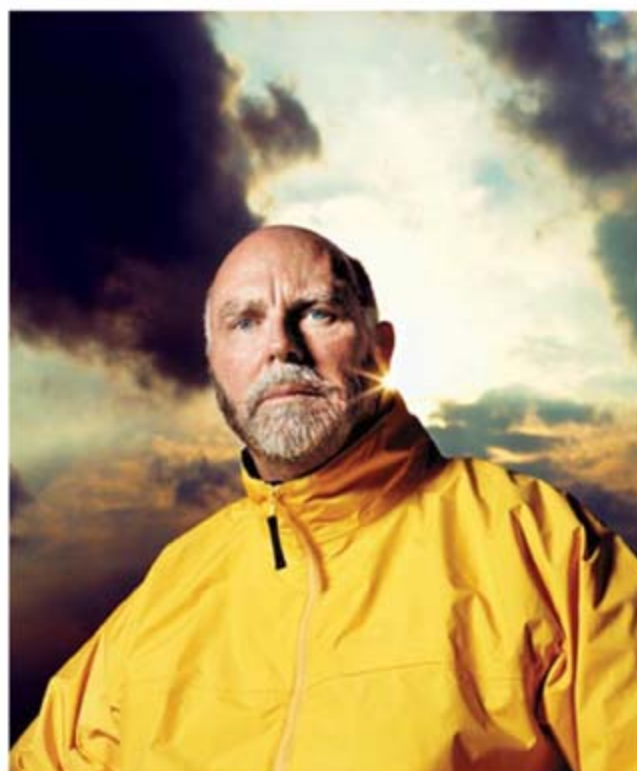
BY JOHN CAREY

FIRST HE SUCCEEDED IN reading humanity's genetic code. Now gene pioneer J. Craig Venter believes he is within weeks or months of creating the world's first free-living artificial organism in his laboratory. It won't be much to look at—a tiny bacterium with only a few hundred genes. But if it's truly feasible, he says, "it will be one of the bright milestones in human history, changing our conceptual view of life."

It also could be lucrative. Venter's company, Synthetic Genomics Inc., has already filed controversial patents on synthetic bugs, which could make fuels such as ethanol or hydrogen. And on June 13 it announced a deal with energy giant BP PLC to find and modify naturally occurring microbes that can turn coal or oil below the earth's surface into cleaner fuel. Microorganisms "have the potential to provide all the transportation fuel we need in the U.S.," says Venter. "I joke that I'm going from the gene king to the oil king."

SWARM OF RIVALS

IN THIS EMERGING FIELD of synthetic biology, though, Venter has plenty of competitors. Amyris Biotechnologies adds suites of genes to yeast or bacteria to make an antimalaria drug and novel biofuels. Dozens of so-called gene foundries, including a Massachusetts Institute of Technology spin-off called Codon Devices Inc. in Cambridge, Mass., have sprung up to sell synthetic strands of DNA and other products. One company, EraGen Biosciences in Madison, Wis., even makes DNA from basic building blocks not found in nature, opening the door wider to new types of life. And many academics are trying to fashion free-living organisms from scratch. So



far, they have synthesized such simpler microbes as the polio virus and the 1918 flu virus.

The benefits of such research could be enormous: not just drugs and fuels but also bugs that clean up pollution or flash when they detect explosives, plus a far deeper understanding of the basic mechanisms of biology. Venter imagines creating organisms worth billions or trillions of dollars.

But the pitfalls could be huge as well. What's to stop terrorists from buying pieces of DNA and fitting them together into a vicious pathogen, frets David C. Magnus, director of Stanford University's Center for Biomedical Ethics. "There are plenty of people lying awake worrying about this," he says.

Magnus and others have been working with DNA foundries, suggesting measures

to reduce the chances of dangerous organisms being unleashed, purposely or inadvertently. One idea: use software to spot purchases of DNA sequences that could be used as weapons. Another is to have "biosafety" officials oversee research to ensure that pathogens created in labs are kept under control. Such measures are still voluntary. "We've essentially made a gamble that the science will keep us one step ahead of any nefarious uses," Magnus says.

Even if synthetic biology can be kept out of the hands of terrorists, some scientists and activists worry that it could be locked up for commercial gain. In early June, the ETC Group, a watchdog organization based in Canada, launched a campaign against Venter's patent application. His synthetic organism will be a much bigger deal than Dolly, the cloned sheep, predicts ETC's Jim Thomas. He charges that Venter's company aims to be the "Microbesoft" of synthetic biology.

LESS SPECIAL

VENTER IS NOT surprised by the attacks on his work. "Patents are a hot word," he says, "and people are afraid of synthetic organisms." He has won kudos for convening panels of bioethicists, religious leaders, and biowarfare experts to study the issues. They've concluded the research shouldn't be stopped—though synthetic organisms must be controlled and contained. Environmental groups should be "ecstatic about what we are doing, since we provide one of the clear alternatives to burning oil and coal," Venter says.

Within weeks, his team expects to publish a paper showing how they have leapt many of the technical hurdles to creating synthetic life. But overcoming objections may not be as easy. While creating new life may not be playing God, says Arthur L. Caplan, director of the Center for Bioethics at the University of Pennsylvania, "it has revolutionary implications for how we see ourselves. When we can synthesize life, it makes the notion of a living being less special." And there's a perception that synthetic biologists may be "manipulating nature without knowing where they are going," he says. "There are arrogant scientists, and our friend Venter may be one of them." ■

VENTER Critics fear that he is aiming to be the "Microbesoft" of synthetic biology

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VENEZUELA

A LOVE-HATE RELATIONSHIP WITH CHAVEZ

Companies are chafing under the fiery socialist. But in some respects, business has never been better

BY GERI SMITH

JUST HOW HARD IS IT TO do business in Venezuela? As President Hugo Chávez leads his country toward “21st century socialism,” hardly a day passes without another change in the rules restricting companies. Want to export? First get government certification that there’s no domestic shortage of your product. Want to import? Prove that the goods aren’t available locally. Chávez has already forced global oil giants, phone carriers, and power companies to hand over control of key assets. Now he says he might nationalize banks, hospitals, and steel companies. No wonder foreign direct investment, which averaged \$3.2 billion annually during Chávez’s first three years in office, plunged to a net outflow of \$2.6 billion last year. “It’s a bit like the...French Revolution,” says Edmond J. Saade, president of the Venezuelan American Chamber of Commerce (VenAmCham). “Power to the people, death to the nobility.”

No doubt, Venezuela is a pretty scary place to invest these days. But in some respects business is better than ever. Thanks to soaring oil revenues, Chávez is spending heavily—some \$13.3 billion

last year alone—to win support for his “Bolivarian Revolution.” For the past three years the economy has grown at an 11%-to-12% clip, while consumption has expanded by 18% annually. The poor, 58% of all Venezuelans, have seen their meager household incomes more than double since 2004 thanks to cash stipends, subsidized food, and scholarships from the government’s social-development programs. The result: Sales of everything from basics such as Coca-Cola and Crest toothpaste to big-ticket items like Ford SUVs and Mercedes-Benz sedans have taken off.

You might call it business’ love-hate relationship with Chávez. Local and foreign companies alike are raking in more money than ever in Venezuela. Two-way trade between the U.S. and Venezuela has never been higher. Venezuela exported more than \$42 billion to the U.S. last year, including 1 million barrels of oil daily, and imported \$9 billion worth of American goods, up 41% from 2005. But since Chávez declared President George W. Bush Public Enemy No. 1, Americans prefer to keep a

low profile, even though VenAmCham’s 1,100 member companies account for more than 650,000 jobs. “Consumption has been going through the roof, and commercial relations between the U.S. and Venezuela are still workable, but on the political front there is confrontation,” says Saade. “American business is caught in the middle.”

UNDENIABLE POTENTIAL

EVEN GLOBAL OIL companies—Chávez’s chief targets so far—are likely to stay put. Although they have been forced to turn over control of their projects to the state-owned Petróleos de Venezuela (PDVSA), Chávez can’t afford to alienate them. Ventures involving foreign companies account for 40% of Venezuela’s output of 2.4 million barrels a day. For the multinational oil giants, the country is too important to ignore, even if it means they no longer call the shots. “Venezuela’s oil potential is so great,” says a foreign oil executive who declined to be identified. “We’re not making huge returns, but it’s not a financial black hole, either.”

Other industries are not only putting up with Chávez but also benefiting directly from his programs. Take Intel Corp.: Sales of its microprocessors in Venezuela jumped by 15% in 2006 and look set to grow at the same pace this year as the government equips schools and public offices with new computers. In December, Caracas started a joint venture with China’s Lanchao Group to manufacture low-cost machines called “Bolivarian PCs.” The venture, 60% owned by Lanchao, will produce 80,000 computers in Venezuela the first year and 150,000 in 2008, including a stripped-down

desktop model that will cost \$450. Intel says the government alone could buy as many as 300,000 computers. “There’s a lot of money in the Venezuelan market now, and it’s important to take advantage of that,” says Guillermo Deffit, Intel’s business-development manager in Venezuela.

Sales of cars and cola are booming, too. Ford and General Motors Corp. have

Despite the political rhetoric, U.S. exports to Venezuela are booming



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manufactured cars in Venezuela for nearly a half-century, but with the strength of the bolivar, imports of pricier models such as the Ford Expedition sport-utility vehicle and GM's Silverado pickup are on the rise. Last year, Ford's sales increased 52%, to nearly 62,000 cars and trucks, as its imports more than tripled, to 28,000. GM's sales jumped 21% last year, to 71,000 vehicles, and so far this year are on track to climb by 50%. And sales of Coke and other beverages made by bottler Coca-Cola

Femsa in Venezuela jumped 25% in the first quarter of 2007, in spite of a two-day shutdown of the company's distribution center in March for a surprise audit by tax authorities.

AN UNCERTAIN FUTURE

FOR LOCAL COMPANIES that have managed to survive Chávez's ever-changing business rules, the fast-growing economy offers some small solace—but few guarantees for the future. "We have fewer competitors every year because people



throw in the towel," says the owner of a family company that provides raw materials for a variety of industries. He declined to give his name, fearing government retaliation, but he says his profit margins are getting fatter as he faces less competition. Still, his company has shrunk to just 100 employees from 300 since Chávez came to power in 1999, and sales have fallen by half. Dozens of his friends have left the country in recent years, and one

RIISING UNREST

When Chávez shut down a popular TV station, students in Caracas protested

who runs Síntesis Financiera, a Caracas think tank. "The government believes that state-run companies...will take the place of the 'exploiting' business class," she notes. "But if you erase the private sector from the map, what do you have left? Not much." ■

LEAVING VENEZUELA

Capital Flight to South Florida

Luxury sedans and SUVs jam the parking lot at the Regions Bank branch in Weston, Fla., near Fort Lauderdale. Inside, dozens of people pack the lobby for a reception to honor the town's Venezuelan residents—a community so large that Weston has been nicknamed Westonzuela. Venezuelan entrepreneurs munch on *arepas* and *empanadas* prepared by a local Venezuelan caterer. Even the mayor has shown up to raise a glass.

South Florida is a prime destination as Venezuelans rush to move their money out of the reach of Hugo Chávez. Capital flight from Caracas is nothing new: Venezuelans have been channeling funds north for decades as they have hedged their bets against economic instability. Nearly every real estate agent has an anecdote about a Venezuelan whipping out a fancy pen to write a check for a condo facing Biscayne Bay. But the pace of the outflow is picking up. As many as 100,000 Venezuelans now live in South Florida, and their numbers are rising.

And there's a new sense of desperation. With their economy growing in the double digits, Venezuelans are less worried about their savings being eroded. Instead, they fear Chávez could confiscate their bank accounts and businesses. "Previous capital-flight dollars were driven by poor economics rather than a controversial leader," says Ken Thomas, a Miami banking consultant who calls the money flowing from Caracas "CD dollars," meaning "Chávez-driven." Venezuelan economist Emilio Medina-Smith, who studies capital flight, estimates that roughly \$1 billion has left the country monthly for the past three years, a big increase from Chávez's first years in power. And bankers in Miami say the latest wave of Venezuelan capital flight reminds them of Fidel Castro's rise in Cuba.

But getting capital out of Venezuela is complicated and expensive. Chávez imposed strict controls in 2003 that limit dollar purchases and require government approval for them. What's more, many

Venezuelans don't want the government to know how much money they have. That's why they turn to the black market to trade bolivars for dollars, even though the rate is nearly double the official level. Then they either travel abroad or make arrangements with relatives or friends that have access to a foreign bank account. "People will pay a premium to take their money out through the black market because they don't want any official record," says Clemente L. Vazquez-Bello, a Miami lawyer specializing in anti-money-laundering compliance.

As Chávez keeps the pressure on, Venezuelans are constantly finding new ways to move their money. One legal method is to buy Venezuelan government bonds and swap them abroad through a broker for dollar-denominated bonds—even though the maneuver is pricey. Another strategy is to buy "gift certificates" from online outfits that will then wire the money to an offshore bank account.

—By Ian Katz in Miami



OFFSHORING

GUESS WHO'S HIRING IN AMERICA

Infosys and other Indian companies are recruiting more locals in the U.S.

BY STEVE HAMM

BENNETT KALCEVIC'S saga offers ample evidence of how the winds of globalization can unexpectedly shift. In the mid-1980s her parents lost their mill jobs when Pittsburgh's steel industry was hit by cheap imports. Now, with a business degree from Michigan State University, Kalcevic has just landed a plum position with Infosys Technologies Ltd., one of the low-cost Indian outfits that many blame for taking jobs from American programmers. After a six-month training stint in India, Kalcevic will return to the U.S. and write software for an Infosys customer. "Outsourcing has angered some people," she says. "It might be easier for clients to deal with Americans locally."

Think of it as offshoring in reverse. In the past, Indian companies almost always transferred Indians to work in the U.S. on temporary visas. But now Infosys

and other Indian outfits are hiring aggressively in the U.S.

Wipro Ltd., for instance, is scouting U.S. locations for two big software writing centers that eventually could employ hundreds of programmers each. Cities on its short list include Austin, Tex., and Atlanta, because of their deep tech-talent pools and reasonable salary costs. "The work we're doing requires more and more knowledge of the customers' businesses, and you want local people to do that," says Wipro Chairman Azim H. Premji. Today only 2.5% of Wipro's global workforce is non-Indian, but the company wants to boost that to more than 10% in a few years.

The Indian outsourcers say their U.S. expansion plans predate the latest concerns over immigration and jobs. But they acknowledge the trend might ease tensions as the Senate mulls regulations that would require companies applying for H-1B visas—temporary working papers for foreigners—to try hiring Ameri-

cans first. "If we can hire close to our clients, we don't have to bring in somebody from India on an H-1B," says S. Padmanabhan, human resources chief for Tata Consultancy Services Ltd. (TCS), India's largest outsourcing firm. About 1,000 of TCS's 10,000 U.S.-based workers are Americans (out of 90,000 total employees worldwide). And it plans to hire an additional 2,000 Americans within three years.

Surprisingly, it often costs more to ship in Indians on a temporary basis than it does to hire Americans. Base salaries are comparable, because

Indian companies must by law pay market rates for people they bring in on work visas. But the companies typically have to provide the Indians with housing, and retirement benefits cost more because of India's social security contribution requirements. Also, as the Indian rupee has risen more than 10% against the dollar this year, hiring Americans has gotten cheaper. At the same time, fierce competition for tech talent in India is pushing salaries there up by 12% to 15% per year, although they remain less than a third of those in the U.S.

ALLURE ON CAMPUS

THE INDIANS ARE recruiting a combination of fresh college grads and experienced vets who have worked at American companies. They're especially active at campus job fairs, and unlike a few years ago students know who these companies are and respect them. In fact, the Indian connection has become an attraction. "I thought this would be a fantastic opportunity, especially because they send you abroad for training," says Brian Oswald, a 23-year-old Rutgers University graduate with a 2006 degree in industrial engineering who joined TCS in February.

The U.S. hiring by the Indians echoes the strategy Japan's auto industry devised after soaring levels of imports sparked political outcry in Washington in December, 2000. "The Indians are doing to the world's IT processes what the Japanese did to manufacturing," says analyst John McCarthy of Forrester Research Inc. And now, like Japan's carmakers before them, the Indians are becoming major employers in the U.S. as well. ■

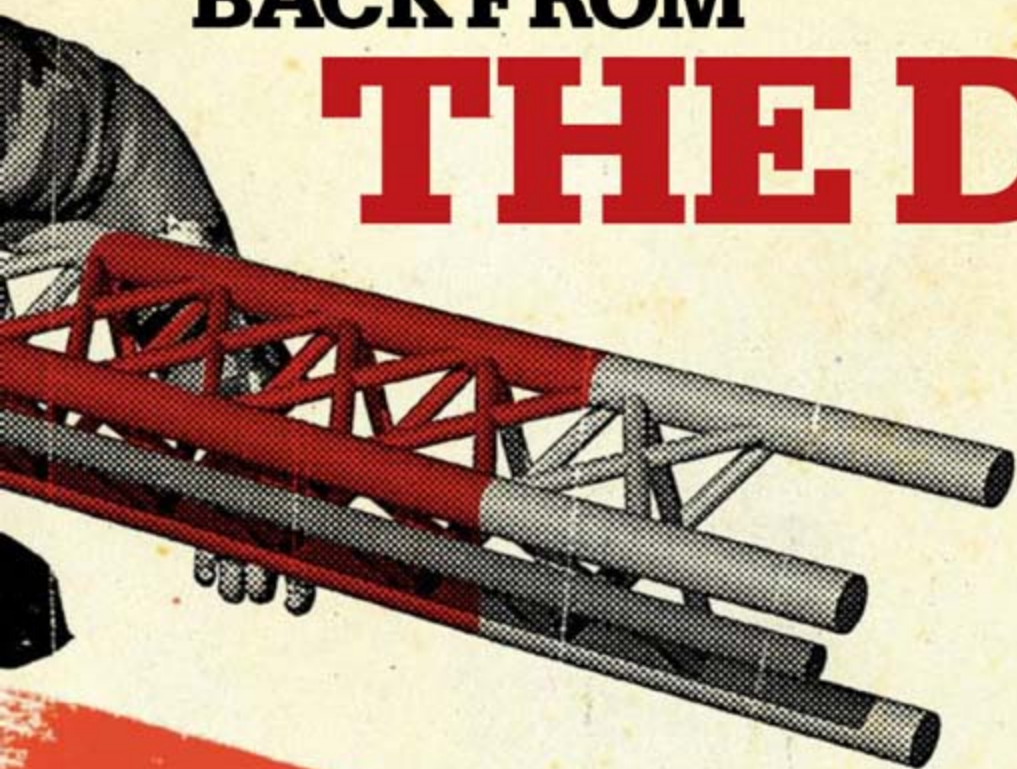


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THE DEAD

BY SPENCER E. ANTE

ILLUSTRATIONS BY TAVIS COBURN



PEALS OF LAUGHTER RIPPLED through the ether in April when hundreds of thousands of people clicked on YouTube.com to watch comedian Will Ferrell's short video, *The Landlord*. It's pretty hilarious, after all, to see a tiny 2-year-old girl in a party dress playing the part of an irate landlord, squeaking, "I am tired of this crap...I want my money!" at Ferrell, her distraught, bushy-haired tenant.

What chuckling viewers couldn't see was the sprawling framework that companies have cobbled together to zap millions of clips like this one around the Internet every day. After a student, say, at Rutgers University in New Brunswick, N.J., clicked on *The Landlord*, one of hundreds of thousands of computer servers in Google's numerous California data centers pushed the video through Web networking gear from Cisco Systems and Juniper Networks. Last year, Google, YouTube's

All those YouTube videos and MySpace pages zipping back and forth on the Net have revived the telecom industry—and charged up the economy

parent company, spent \$1.9 billion, or 18% of its sales, on technology systems and other capital expenditures to serve videos speedily and process search-engine queries.

From Google's facility, the video shot across the U.S. on Level 3 Communications Inc.'s fiber-optic network, which encompasses 47,000 miles of cable. Reaching New Jersey, the clip was then handed off to a new fiber loop run by Verizon Communications Inc. Milliseconds later, Verizon served up the video to an apartment in New Brunswick through a broadband connection wired directly into the building.

In those taken-for-granted wires, cables, and computers lies a remarkable tale of resurrection. Seven years ago the communications business,

made up of companies providing everything from phones to computer networks to routers and switches, was laid low by the worst collapse to hit a U.S. industry since the Great Depression. With breathtaking speed and little advance warning, high-flying companies like Global Crossing Ltd. and WorldCom Inc., which had loaded up on debt to build out fiber-optic networks and buy up companies in anticipation of a never-ending e-commerce boom, collapsed into bankruptcy. Giants such as AT&T were ripped apart as they scrambled to recover from free-falling sales and profits. Hundreds of thousands of workers lost their jobs. Prices of some inflated stocks—boasting price-to-earnings ratios that topped 400 in the most extreme cases—tumbled 95% or more.

Investors saw some \$2 trillion of market value vanish in a little more than two years—twice the damage caused by the parallel bursting of the Internet bubble. Amid the wreckage, some predicted it could take a decade or more before the industry would climb back and fill all those empty pipes that starry-eyed executives had buried beneath the earth and oceans.

Over the past year, however, the telecom industry has roared back to life. Credit a steady rise in appetite for broadband Internet connections, which enable easy consumption of watch-my-cat video clips, iPod music files, and such Web-inspired services as

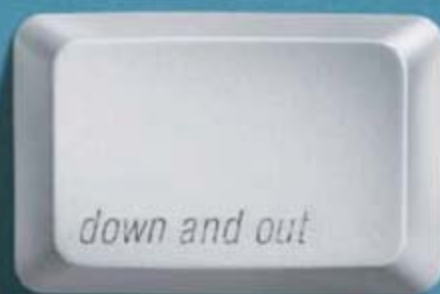
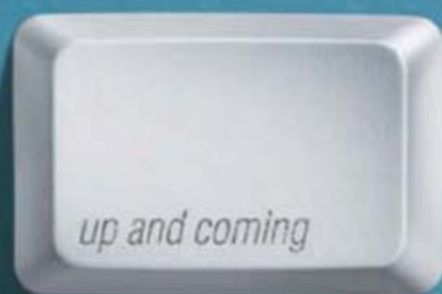
free Internet phoning. Indeed, this year broadband adoption among U.S. adults is expected to cross the important threshold of 50%. Capital spending is on the rise as companies invest to build high-speed networks. Private equity players are placing enormous bets on the industry, such as the \$8.2 billion that Silver Lake Partners and the Texas Pacific Group agreed to pay for networking gearmaker Avaya on June 5. And the glut in broadband communications capacity is all but gone.

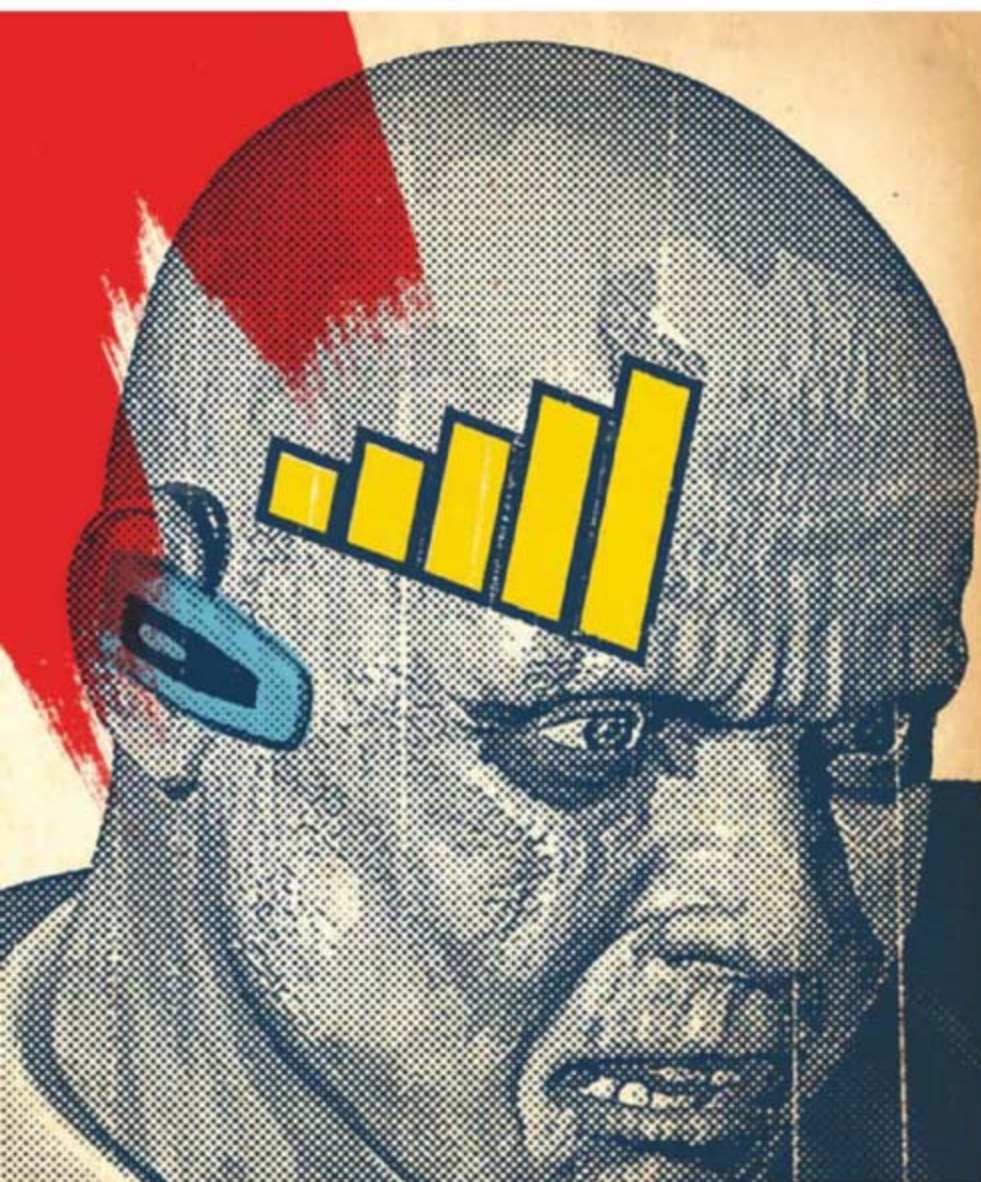
About half of the Internet's transmission capacity was going unused in 2002. Today that pipeline has almost doubled in size, and yet the unused portion is down to about 30%. As a result, the price that companies pay for bandwidth in some parts of the U.S. is on the rise after six years of declines. "All of us are planning expansions of our backbones in order to support growth in Internet applications and video," says Dan Yost, executive vice-president for product at Denver-based communications provider Qwest Communications International Inc.

Perhaps the best indicator of the telecom revival is this startling data point: Profits for the industry this year are expected to reach an all-time high of \$72 billion, topping for the first time the high-water mark of \$65 billion in 1998.

You don't have to tell investors that telecom is back. It has been one of the hottest sectors in the stock market over the past 18 months. In 2006 big phone company and other stocks represented in the Telecom HOLDRS exchange-traded fund rose 34%, after a nearly 10% decline in 2005. And the fund is up 14.8% so far in 2007, compared with a 7.7% gain for the Dow Jones industrial average.

But telecom's revival has implications way beyond Wall Street. A dollar spent on telecom infrastructure produces an outsize impact on the U.S. economy as a whole. Indeed, a growing body of research has found that telecom investment plays a vital role in stimulating economic growth and productivity—more so than money spent on roads, electricity, or even education. Communication assets generate massive benefits by slashing the cost of doing business across the economy. A high-speed data network suddenly makes it easier and cheaper for all kinds of workers to place orders, service customers, and drum up new business.





A 2001 paper in the *American Economic Review*, written by Lars-Hendrik Röller of Berlin's Social Science Research Center and Leonard Waverman of the London Business School, concluded that the spread of land-based telecommunications networks in 21 developed nations accounted for one-third of the increase in economic output between 1970 and 1990. Other studies suggest fiber-optic and wireless networks provide their own special jolt to the economies of rich and poor nations alike. "Out of the ashes of the tech crisis we got a world-class, spanking-new communications network," says Mark Zandi, chief economist for Moody Corp.'s Economy.com Inc. "That has been key to outsized productivity gains ever since."

The \$900 billion industry looks far different than it did

in 2000. The balance of power has shifted toward Web upstarts such as YouTube and MySpace that barely registered seven years ago. The Bell phone companies, meanwhile, have consolidated and are furiously developing services they hope will let them capitalize on the billions they're investing to build speedy new networks.

It's not clear, though, how much of the value flowing from those networks will be captured by the Bell companies themselves. The big phone companies don't have a history of developing game-changing technologies in a competitive arena. "They've got a high hill to climb," says William E. Kennard, a former Federal Communications Commission chairman who is now managing director of Carlyle Group, a large private equity firm that has purchased some telecom assets. Meanwhile, Web companies such as Google are making a push to introduce more competition into the wireless industry and loosen the Bells' control over the Internet's distribution (page 54).

The long-awaited arrival this month of Apple Inc.'s iPhone, which surfs the Web, takes pictures, plays music—and oh, yeah makes phone calls—may herald a new round of disruption for the big telcos. By allowing software developers to write applications for a better mobile Web device, Apple is attempting to shatter the so-called walled-garden model of wireless companies in which they control the wireless Internet gateway and the content that is featured on the handset

screen. If the iPhone's Web browser performs as hyped, customers could start demanding a full range of Internet service on their phones and new freedom in their service plans. That, in turn, could create ever more demand for servers and routers, video services, and upgraded wireless networks.

Within the broad industry comeback are some remarkable turnarounds. Few companies got whipsawed harder by the bust than Level 3 Communications. Founder and Chief Executive James Q. Crowe started Level 3 in 1998 with a dream of building the world's largest, most advanced fiber-optic network—and with \$3 billion raised from investors that included Walter Scott Jr., an Omaha construction magnate and friend of Warren Buffett. Before long, the company was digging up

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earth in 20 time zones with 250 crews installing fiber at a blistering pace of 19 miles a day. In March, 2000, Level 3's stock peaked at \$130 a share. But with money flowing like water, by the end of the year at least 50 other companies jumped in to offer Internet backbone services. When it became apparent that Crowe's network was attracting more competitors than customers, the stock tumbled off a cliff, nearly killing the company. By October, 2001, it had bottomed out at \$1.98 a share, sticking investors with tens of billions in losses.

Today, Level 3 is alive and growing again. Over the past three years a strong bond market enabled the company to refinance its massive debt

at lower rates and pull off 10 acquisitions worth more than \$4 billion. Level 3 says more than half of its network traffic today is from Web video, vs. no such traffic in 2000. High debt levels are keeping its business in the red; analysts don't expect Level 3 to generate positive cash flow until the end of this year. But over the past nine months, Level 3's stock has jumped 60%, to about 5½, as it reaps a kind of survivor's premium. "For a long time they were on death watch, but now they are the last guy standing in the U.S. wholesale [bandwidth] business," says Stephan Beckert, an analyst with Washington-based TeleGeography Research.

Now even some initial public offerings are drawing interest on Wall Street. Shares in Dallas-based wireless service provider MetroPCS Communications Inc. have jumped nearly 50% since the company went public on Apr. 22 at \$23 a share. The stock price of communications gearmaker Riverbed Technology Inc. has more than quadrupled, to 40, since a September, 2006, IPO. "There's a huge amount of startup innovation" in the communications industry, says Morgan Jones, a partner with Battery Ventures, a venture-capital firm in Waltham, Mass., that invested in MetroPCS.

Of course, that's how it felt back in 2000—in spades. Then, it seemed as if demand for optical routers, "pump lasers," and other whiz-bang broad-

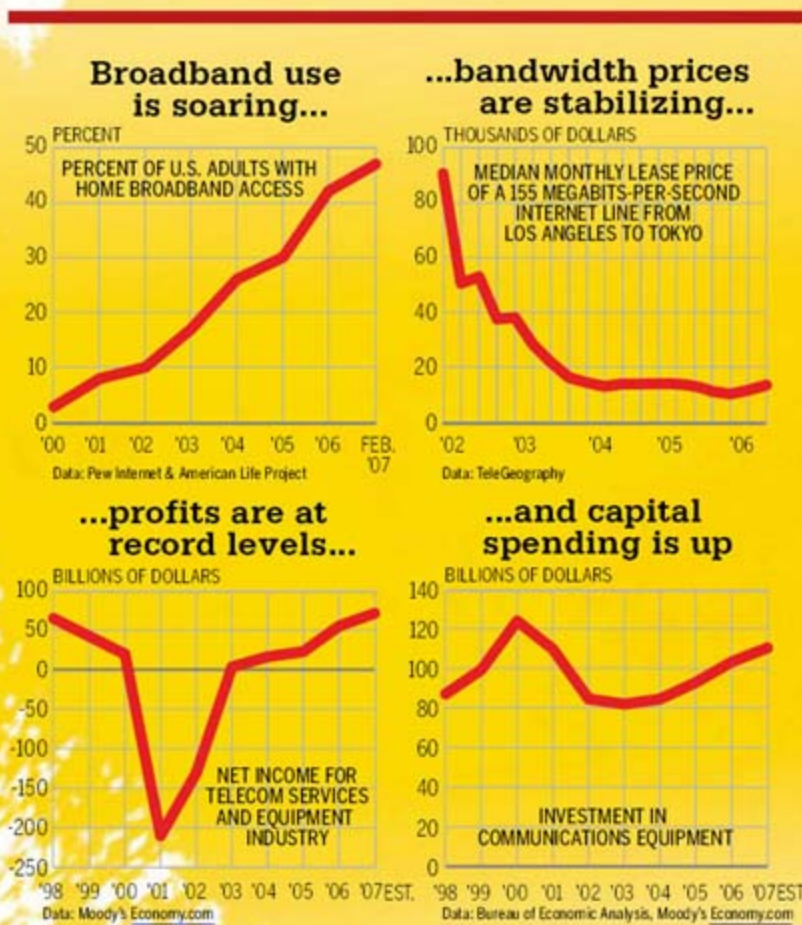
band technologies would grow forever. But when dot-coms started flopping in the spring of 2000, the absurdity of projections calling for Internet traffic to double every three months was revealed. The capital spigot, which had been gushing with cash for upstart phone companies and established carriers alike, shut off. With too many bandwidth providers chasing falling demand, wholesale Internet connection prices began falling by 50% a year.

The first big dominoes fell in 2001, when broadband providers Winstar Communications and 360Networks filed for bankruptcy. Over the next three years 655 telecom companies, with a combined \$749 billion in assets, filed for bankruptcy, according to BankruptcyData.com. On July 21, 2001, after an accounting scandal revealed billions of dollars of overstated profits, WorldCom Inc., the giant that embodied the boom era's promise, filed the largest bankruptcy claim ever.

The scope of the wipeout was breathtaking, conjuring comparisons with the savings-and-loan crisis of the 1980s. But this time it was private investors who ate the losses, not the government. And the speed of creative destruction had one advantage: By early 2004, recovery was already under way. In a key deal in February of that year, Cingular Wireless agreed to buy AT&T Wireless Services for about \$41 billion. Soon the consolidation shifted into overdrive. In December, Sprint announced a deal to buy Nextel Communications for \$35 billion; a month later, SBC Communications said it would buy AT&T for \$16 billion; a month after that, Verizon struck a deal to acquire MCI, the former WorldCom, for \$8.4 billion.

But while the phone and cable companies tightened their grips on the transmission pipes, an army of upstarts went to work filling them. It's no accident that the explosion of online video and the re-birth of telecom happened around the same time. A typical video consumes 1,000 times as much bandwidth as a sound file. (Likewise, high-definition video, which consumes 7 to 10 times as much bandwidth as normal video, could trigger the next surge in network growth.)

Online video barely existed in 2000. Today, fully one-third of all Internet traffic comes from Web videos, *The Landlord* included. Thanks to bandwidth-hungry services such as YouTube, global Internet traffic from 2003 to 2006 grew at a compounded annual rate of 75% a year, according to TeleGeography. "When you compound those numbers, I don't care how much inventory you have,





it's going to disappear off the shelf," says Level 3 CEO Crowe.

To understand the velocity at which video is taking over the Web, consider the experience of VideoEgg Inc. While not nearly as well known as YouTube, VideoEgg in less than two years has grown to become the largest video service for social-networking Web sites. Instead of building their own Web video services, big online communities such as Bebo and hi5 use VideoEgg technology to let members broadcast videos on their sites.

Today, VideoEgg serves up about 15 million videos a day across 70 Web sites. To deliver them, the company works with giants such as AT&T and Verizon as well as Web content-delivery service Akamai Technologies. By yearend, VideoEgg CEO and co-founder Matt Sanchez believes the company could more than triple its current traffic.

Mainstream organizations also have knit broadband networks into the fabric of their daily operations. Take something as simple as mail delivery. Since 2005 the U.S. Postal Service has been using wireless scanners so mail handlers

can keep tabs on the location of every one of the 200 billion pieces of mail it delivers in a year. And it is now testing a wireless system that will keep track of thousands of mail trailers parked in its 22 bulk mail centers. Since 2001 the Postal Service has boosted its network capacity tenfold to support these systems. As a result, the service has become a major buyer of telecom infrastructure, spending hundreds of millions of dollars a year on communications services provided by Verizon and AT&T.

Indeed, while companies remain tightfisted in their spending on computers and other information technology, many of them believe new networks provide a big bang for their bucks. Global spending on communications equipment for corporations is forecast to grow 20% over the next three years, according to Infonetics Research of Campbell, Calif. Consider the experience of clothing maker Liz Claiborne Inc.: In late 2005 employees were becoming increasingly frustrated when it was taking up to half an hour just to open up a 40-megabyte spreadsheet. After the

A SCRAMBLE FOR THE PERFECT WAVE

LATER THIS YEAR the most valuable slice of American airwaves is set to be auctioned off by the Federal Communications Commission. A growing number of consumer groups and technology titans, including Google, Intel, and Yahoo!, argue that the auction is the last, best chance to create a broadband competitor to the phone and cable companies.

This patch of UHF wireless spectrum—television channels that must be vacated when broadcasting goes digital in February, 2009—is viewed as beachfront property because it can penetrate buildings, mountains, and earth. Moreover, a network in this band would be cheaper to build than existing Wi-Fi and WiMAX networks, since UHF signals travel much greater distances. The auction could generate as much as \$20 billion for the U.S. Treasury.

But big tech players are likely to pony up bids only if they can change the way the auction operates, which will be determined by July. Unlike auctions on eBay, wireless spectrum sales are governed by an incredibly complex and changing set of rules.



The problem, say critics, is that the rules have favored incumbent wireless giants. In last year's auction, Verizon Wireless, AT&T, and T-Mobile bought a combined 61% of the \$13.7 billion in spectrum licenses.

Google, Intel, and other techies are pushing the FCC to create licenses for larger geographic areas and allow "package bidding" so one company could assemble a

nationwide franchise by bidding on a combination of licenses. "If you have that much power concentrated in a few players, they will have the incentive to limit or forestall innovations," says Richard S. Whitt, Google's Washington telecom and media counsel.

Verizon is vehemently against proposed rule changes that would prevent incumbents from bidding or allow winners to sell spectrum wholesale—moves that might make it easier to create a new nationwide player. "The best thing the government can do to ensure that the country remains competitive in broadband is to open the auction to all bidders," says Steve Zipperstein, vice-president for legal and external affairs at Verizon Wireless.

Despite the fervor for a new entrant, most analysts believe it's unlikely one will materialize. Few companies can afford the multibillion-dollar price tag required to build a national network; even Google and Intel have refused to commit to entering the auction. FCC Chairman Kevin Martin, though, favors package bidding and remains optimistic: "I'm hopeful about a new entrant if we set it up right."

— Spencer E. Ante

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company installed new gear from Riverbed Technology that compresses the files and stores the most popular data closer to the users, documents popped open in a few minutes. "People were like, 'Wow, I can't believe how fast this is,'" says Rakesh Patel, Liz Claiborne's technical architect.

If the old telecom world was dominated by bloated regional monopolies, the new world is a competitive mosh pit stocked with sinewy players. That's reflected in how much more productive the industry has become.

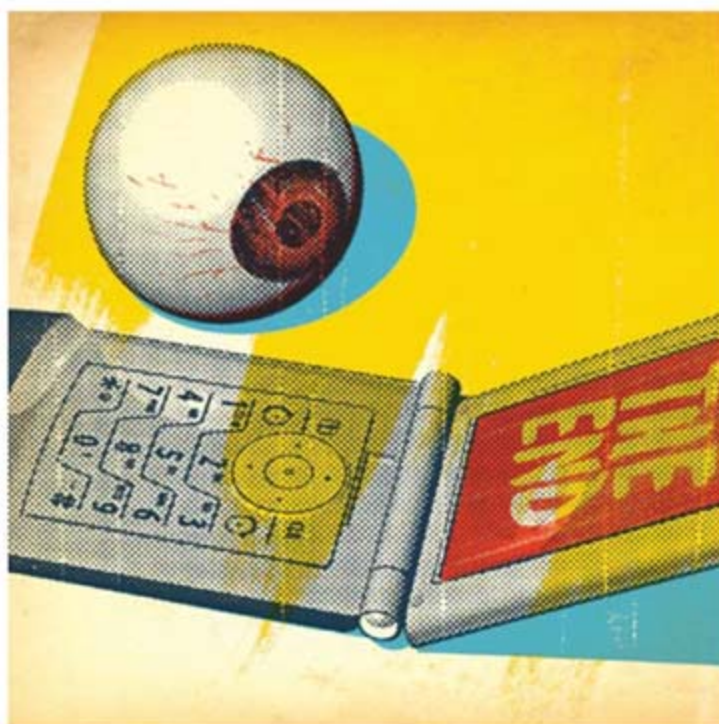
While telecom revenues are now 19% higher than they were in 2000, that money supports just 1.1 million workers, down nearly 30% from boom-era levels. "It has gotten unrelentingly competitive in every area: broadband, land line, and wireless," says AT&T's new CEO, Randall Stephenson.

For the big carriers such as AT&T, Verizon, and Qwest, the main challenge is to slow defections of traditional land-line customers while

producing faster revenue growth in new markets such as wireless, Internet service, pay TV, and advertising. The carriers must overcome their reputation for being "dumb pipes" and prove they can fill their networks with innovative bundles of products and services that strike a chord with customers—all while battling cable operators, which are poaching millions of phone customers, and fending off or making peace with aggressive new entrants such as Google and Apple.

There is reason to believe the phone companies are re-inventing themselves. Verizon, for example, will soon offer services that allow consumers to personalize and share photos, videos, and other media among their cell phones, PCs, and TVs. Five years ago, Verizon employed about 100 software developers who were mostly focused on installing products developed outside the company. Today, Chief Technology Officer Shaygan Kheradpir oversees more than 1,000 developers. In July the company will launch an interactive media guide for Verizon's FiOS TV service; by clicking on it, couch potatoes can access all of the photos, music, and videos they have stored on a PC. Further down the road, Verizon says it will steal a page from YouTube and allow TV customers to create their own personalized video channels. "We don't have to own every service," says Verizon CEO Ivan G. Seidenberg. "We just have to package a lot of them and help the customer find the things they like."

It doesn't help that American phone companies can no longer rely on the wireless business for growth as much as they have in the past. Mobile telephony is a maturing market. For the first time, this year the growth rate for new wireless subscribers in the



U.S. is expected to decline. To continue generating double-digit revenue growth, wireless carriers must steal customers from one another or persuade more consumers to buy next-generation phones and purchase so-called 3G services such as games, music, and videos. Every major wireless service provider is upgrading its networks to provide faster speeds for uploading and downloading wireless content. But only 15% of the wireless handsets

in the U.S. are capable of handling 3G services.

That raises a troubling question: Could another unpleasant surprise await investors who have bought into this shiny image of telecom transformation? Maybe. Some of the projections for new mobile-phone businesses, especially video downloads, seem over-the-top in a late-'90s kind of way. But there's nowhere near the sense of limitless expectations that drove telecom investors off the cliff last time. Despite strong performances of late, stocks such as AT&T, Verizon, and Cisco Systems are trading today at 15 to 20 times 2007 earnings. Cisco's price-earnings ratio in 2000 hit 145.

Perhaps Cisco, the No. 1 seller of network gear, is emblematic. In what seemed at the time like a milestone in the Net's ascendency, Cisco briefly passed Microsoft Corp. in March, 2000, to become the most valuable company on the planet. Soon after, Cisco had to write down \$2 billion of unsellable routers and other equipment. By July, 2002, its stock price had tumbled from 77 to 12. Cisco cut costs, laid off workers for the first time, and weathered the storm. Today, it is flowering again, selling equipment to cable and phone companies that are expanding their services, and branching out into new business and consumer markets. In the most recent quarter, the company reported profits of \$1.9 billion, up 34%, on strong sales of \$8.9 billion. On June 12, the stock was trading around 26.

CEO John Chambers tells a post-bust story that sums up how quickly things have turned around. Back in 2004, he recalls, critics laughed when Cisco rolled out an audacious new router, the CRS-1, capable of transmitting the entire contents of the Library of Congress in a few seconds. Analysts predicted only a handful would sell. This year, thanks to the video bandwidth hogs, sales of the CRS-1 are expected to hit \$1 billion, more than double the figure for 2006. Says Chambers, who has never lacked for confidence throughout the boom, bust, and boom again: "The market is going exactly where we thought." ■

—With Peter Burrows in San Mateo, Calif., and Roger O. Crockett in Chicago

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TAKING THE PULSE OF TELECOM

ONLINE: A slide show highlighting the videos, games, and other Internet applications fueling telecom's surprisingly quick revival.

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THE CEO MAYOR

THE AMERICAN BUSINESS-man-politician has a long and storied history. From Alexander Hamilton (industrialist) to Herbert Hoover (mining consultant) to New Jersey Governor Jon Corzine (CEO, Goldman, Sachs & Co.), wealthy and connected executives have, for better or worse, tried to bring corner-office management to the public arena. With the arrival of George W. Bush, MBA, we began to hear a lot about the so-called CEO President who was supposed to muster a greater degree of executive decisiveness and accountability. But four years of war and the Katrina debacle have blunted that talk.

Which brings us to New York City Mayor Michael R. Bloomberg. This forthright and prosaic 65-year-old billionaire just may have the right combination of managerial, risk-taking, and political skills to create a new model for public service—possibly even at the national level should Bloomberg run for President.

Applying lessons from an early career on Wall Street and from two decades building his eponymous financial-information and media empire, the mayor is using technology, marketing, data analysis, and results-driven

HOW NEW YORK'S
MIKE BLOOMBERG
IS CREATING A NEW
MODEL FOR PUBLIC
SERVICE THAT
PLACES PRAGMATISM
BEFORE POLITICS
BY TOM LOWRY

incentives to manage what is often seen as an unmanageable city of 8 million.

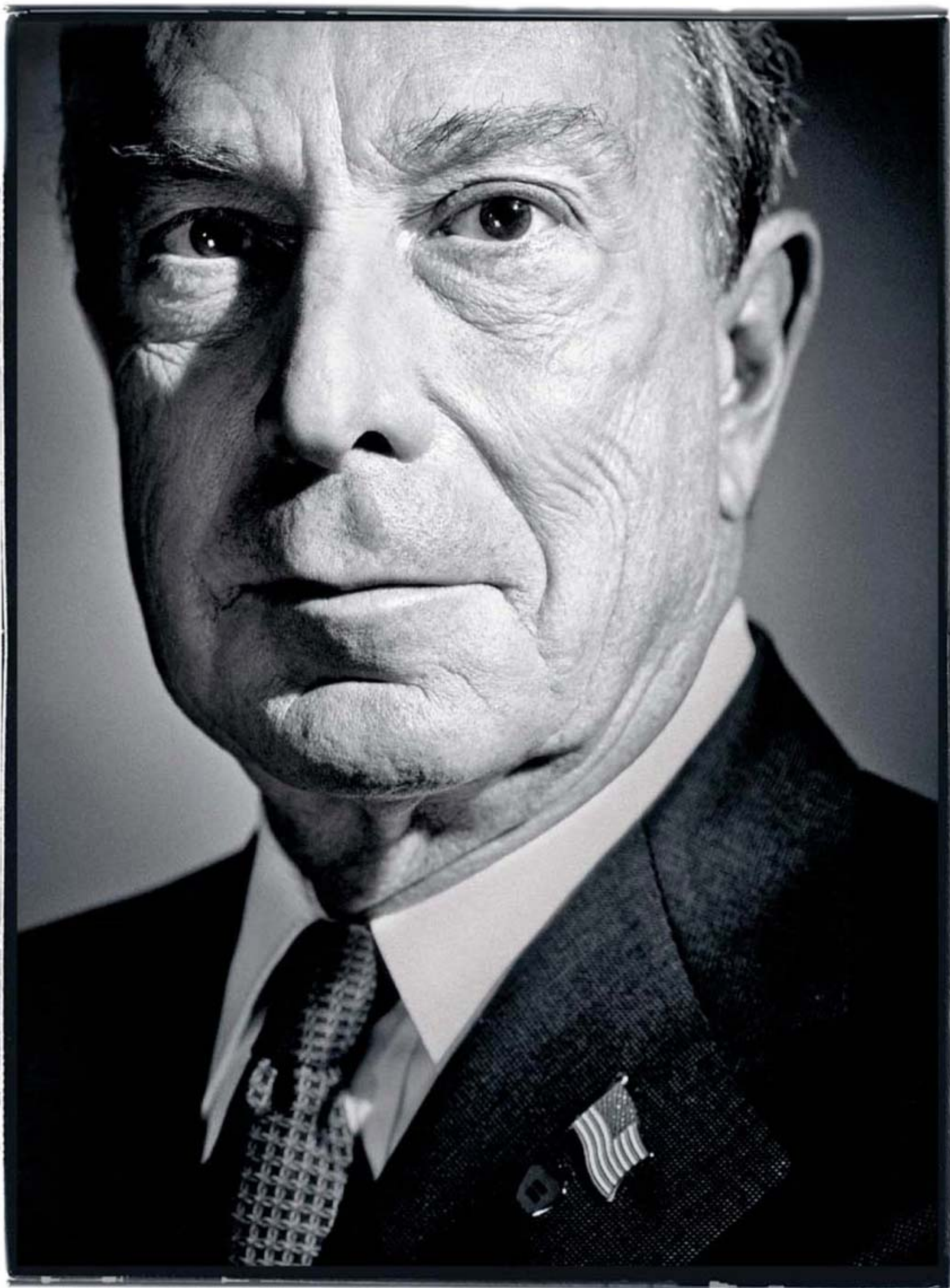
Bloomberg sees New York City as a corporation, its citizens as customers, its sanitation workers, police officers, clerks, and deputy commissioners as talent. He is the chief executive. Call him a technocrat all you want; he's O.K. with that. "I hear a disparaging tone, like there's something wrong with accountability and results," he

says. "What was I hired for?"

Yes, Bloomberg has endured setbacks. His failed attempt to build a football stadium in Manhattan gobbled up time and energy for much of his first term. And while his takeover of city schools five years ago from the state has led to dramatically improved test scores, there is a long way to go before the mayor can declare victory. Plus, some of his ideas—including his suggestion to pay kids for good grades—grate on educators.

Yet his checklist-obsessed operating style has resonated with New York's famously cynical citizenry—70% approval ratings attest to that—and well beyond Gotham. "People see that this can be done in a place like

NIGEL PARRY/CPI





New York, effectively managing something so large and complex," says Time Warner CEO Richard D. Parsons, a Bloomberg friend and someone mentioned as a possible mayoral candidate himself. "And they think, 'Hey, this can be done elsewhere.'"

The City Is a Brand

PUT YOURSELF IN BLOOMBERG'S size 9½ loafers on Jan. 1, 2002, the day he was sworn in as New York's 108th mayor. The city was grappling with the psychological and financial impact of the terrorist attacks. It faced a budget gap of nearly \$6 billion. On Wall Street, there was talk of abandoning Manhattan for the safer precincts of New Jersey or Connecticut.

Bloomberg had three options: cut services, raise taxes, or both. He did what no mayor had dared to do in more than a decade: He jacked up property taxes. And he didn't agonize over the decision a bit. "It [was] easy to make that choice," he recalls.

Some of his aides tried to talk him out of it, fearing the move amounted to political suicide. And by the following summer, Bloomberg's approval ratings had plunged, to 31%. But the novice mayor was undeterred. Where most politicians would have seen only a fiscal solution to the budget gap, he spotted a marketing opportunity. He was protecting the New York City "brand." Bloomberg saw a low crime rate, good public transportation, and clean streets as indispensable to selling New York. Cutting back on services, he felt, would send the wrong

message to the business community and the outside world.

At the same time, Bloomberg boosted New York's promotional efforts. First, he consolidated three existing operations under a not-for-profit entity called NYC & Co. He tripled the city's contribution to the annual marketing budget, to \$22 million. Then he went out and hired as CEO a veteran ad man, George Fertitta, whose branding and marketing firm had handled the likes of Coca-Cola, Perry Ellis, and Walt Disney. All cities have marketing arms. But Fertitta's operation is essentially an advertising agency with an in-house creative services unit that uses various media, from bus shelters to the city's cable channel, to help sell the Big Apple.

Bloomberg doesn't mind being called a technocrat. "I hear a disparaging tone, like there's something wrong with accountability and results," he says. "What was I hired for?"





Bloomberg has made City Hall "see-through," complete with a newsroom-style, open-plan "bullpen" office and glass windows in all the meeting rooms.

branch offices around the world. Today, NYC & Co. has a presence in 14 cities, with new offices set to open in Seoul, Tokyo, and Shanghai in coming months.

Since 2003, New York says it has added 151,100 new private sector jobs, boosting the economy and fueling a construction boom. And last year, partly owing to a weak U.S. dollar, the city reports attracting 44 million visitors, up from 35 million in 2002. As for that 18.5% property tax hike, it got a whole lot easier to swallow when the average value of a single family home surged by 55%. Now, with the city in surplus, Bloomberg plans to hand out \$1.3 billion in tax cuts not only to homeowners but also to businesses and shoppers.

Ever the metric junkie, Bloomberg set a goal for NYC & Co.: lure 50 million visitors a year by 2015. And knowing that foreign tourists spend three times as much as U.S. visitors, he ordered Fer-

titta to open more

The Voters Are Customers

BLOOMBERG THE EXECUTIVE was obsessive about catering to his customers, establishing 24-hour call lines, collecting data to help develop new products, and sending his executives out into the field to solicit feedback directly from clients. "Good companies listen to their customers, No. 1," he says. "Then they try to satisfy their needs, No. 2. But don't let [them] drive the internal decisions of the company."

As daunting as it may sound in a city never shy about complaining, Bloomberg decided New York needed its own 24-hour customer-service line. Yes, other cities had deployed 311 numbers, but never on such a grand scale. The benefit, beyond giving the public a new outlet to vent, would be making city government more efficient.

One month after being sworn in, Bloomberg proposed a 311 line that would allow New Yorkers to report everything from noise pollution to downed power lines. More important, 311 would give the mayor unprecedented access to what was on his constituents' minds. Bloomberg sees the weekly reports and gets a sense of the citizenry's angst—and whether problems are getting solved and how quickly.

Since it launched in March, 2003, at a startup cost of \$25



Special Report

million, 311 has received 49 million calls. The service employs 370 round-the-clock call takers. And New York has done an impressive job of data-mining the calls and quickly responding, says Stephen Goldsmith, the former mayor of Indianapolis and now a professor at Harvard's Kennedy School of Government. "Something special is going on in New York," he says. As far as the mayor is concerned, the numbers tell the story. Emergency 911 traffic is down by 1 million calls since 311's inception, meaning first responders are being called to fewer non-emergencies. The Buildings Dept. uses 311 to streamline the permit process and the review of plans by inspectors. The average wait time for an appointment with a building inspector has dropped from 40 days to less than a week. Two years after 311 launched, inspections for excessive noise were up 94%; rodent exterminations, 36%.

Heather Schwartz, a 30-year-old graduate student, is a regular user of the 311 line and says she became a big fan last year when she called about graffiti in a northern Manhattan subway station. Within days, the walls were painted over. Each time the graffiti artists returned, the city would paint over their handiwork. Finally the vandals gave up. Now Schwartz calls 311 for everything from elevator inspections to trash in the streets. "I am thrilled with it," she says. "It professionalizes the city."

The More Light, the Better

EARLIER THIS YEAR, during a morning meeting with top staffers, Bloomberg noticed the large doors to the ornate conference room in City Hall. They were wooden. How could that be? Bloomberg thought he'd made City Hall "see-through." All meeting rooms had glass windows, so you could look inside. His desk

and those of his staff were clustered in a room without walls to facilitate better and faster communication. By week's end the room had glass doors.

Bloomberg has tried to make the government and its agencies more open, too. In a task that previously fell to city budget directors, Bloomberg himself each year makes three budget presentations in the same day: one to city council, another for other elected officials, and one to the press. He uses easy-to-follow charts and tables, much like a CEO's Power Point presentation to analysts. His hope is that, by explaining the forces shaping the city's economy, a better understanding of his tax and spending priorities will emerge. The approach has not only helped him in budget negotiations with city council but also fostered a smoother relationship with civic and advocacy groups, says Mitchell Moss, an urban policy and planning professor at New York University.



NINA BERMAN/REDUX



BOLDMOVES





Most politicians fill the top jobs with people to whom they owe their support. Bloomberg has endeared himself to voters by hiring lieutenants who can get the job done.

summaries available online, are now fully accessible on the city's Web site. Before, a New Yorker could never see a specific agency's overhead costs—its pensions and legal claims, say. The costs were pooled as a single number. Now each agency breaks them out.

Hire Smart and Delegate

THE FIRST THING most politicians do upon winning office is fill top jobs with people to whom they owe their support or who have long-standing ties to the political Establishment. Bloomberg arrived at City Hall with no such debts. That's partly because he financed his own campaign. But even if he hadn't, Bloomberg says, he still would have recruited his lieutenants based on their ability to set targets and hit them.

And by and large, that is what he has done. Not surprisingly, he reached into the business community, appointing a former partner of private equity firm Oak Hill Capital Partners named Daniel Doctoroff to run New York City's economic development office. And he brought over four of his executives from Bloomberg itself. One of them was Katherine Oliver. Bloomberg had a turnaround mission in mind for her at the city's Office of Film, Theatre & Broadcasting.

Oliver was working in London, overseeing Bloomberg global radio and television operations, when she got the call. Her marching orders from the mayor were simple: build a customer-service organization. She wasn't prepared for how much the film office needed modernizing and refocusing. Toronto and Louisiana, among other places, were stealing business from New York. Production companies were required to visit the office and fill out permit applications on paper. And to Oliver's astonishment the

What's more, citizens can get a closer look at their city government than ever before. The semiannual mayor's management report once exceeded 1,000 pages in three printed volumes. Today, the report—which reviews the delivery of city services—is 186 pages, available online, and includes many more features than before, including neighborhood data and five-year trends that allow New Yorkers to compare past and present. In addition, the city plans and budget, once convoluted fiscal documents with only

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*Government star ratings are part of the National Highway Traffic Safety Administration's (NHTSA's) New Car Assessment Program (www.safercar.gov). **Class is 5-passenger large car. †EPA estimated 18 city/28 hwy mpg, FWD.



"In business, you reward people for taking risks. When it doesn't work out, you promote them because they were willing to try new things. If people tell me they skied all day and never fell down, I tell them to try a different mountain."

agency had only one computer. Most staff were tapping away on electric typewriters.

Within a month of her arrival, her 22 employees had new Dell flat-screens, and production companies were able to file for permits online. Approvals have since surged to 200 a day, up from 200 a week in 2002. Oliver also put a photo library on the Web site, letting producers scout locations from their desks. She began offering a combined 15% tax credit to film and TV productions that complete at least 75% of their stage work in the city. Oliver says the program has generated \$2.4 billion in new business and 10,000 new jobs since 2005. She offered filmmakers free advertising space on public property. And she set up a dedicated team of 33 police officers to ease shoots in the city. "We tried to look at this as B to B," says Oliver. "This is a microcosm of what Michael wanted to do for the entire city."

The movie industry isn't complaining. Veteran producer Michael Tadmor says the city's film office is much more efficient. "You get maps, diagrams, and suggestions of where to shoot during one-on-one meetings with folks in the office," says Tadmor, who just completed filming a remake of *The Omega Man*, *I Am Legend*, in New York. "I have always felt big cities should be run by businesspeople, not politicians."

Be Bold, Be Fearless

"A MAJOR PART of the CEO's responsibilities is to be the ultimate risk-taker and decision-maker. Truman ('The buck stops here') had it right." So wrote Bloomberg in his 1997 autobiography *Bloomberg By Bloomberg*. The mayor has embraced risk with an almost reckless disregard for political repercussions. Sometimes it has worked out: His controversial smoking ban in bars and restaurants is being replicated in other cities. Sometimes it hasn't: In a crushing defeat, he lost the 2012 Olympics bid to London.

Bloomberg recently reflected on the rare setback. "In business, you reward people for taking risks. When it doesn't work out, you promote them because they were willing to try new things. If people come back and tell me they skied all day and never fell down, I tell them to try a different mountain." He adds: "I have always joked that [the difference between] having the courage of your convictions and being pigheaded is in the results."

Bloomberg has two and a half years left in his second term, so it's a little early to talk about legacy. But the influence of this self-made billionaire will be felt by generations of politicians. One is Adrian Fenty. Washington's 36-year-old mayor has adopted the newsroom-style office, or bullpen, that Bloomberg brought from his company, and is now seeking a Bloomberg-style overhaul of his city's own chronically underperforming schools.

What has Bloomberg learned as mayor? "The real world, whether in business or government, requires that you don't jump to the endgame [or] to success right away," he says. "You do it piece by piece. Some people get immobilized when they come to a roadblock. My answer is, 'you know, it's a shame it's there, but now where else can we go? Let's just do it.'" ■

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MANAGING GOTHAM

ONLINE: Senior Writer Tom Lowry narrates a slide show and analyzes New York City Mayor Michael Bloomberg's private sector management approach to running the nation's largest city.

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The Murdoch Who Could Be King

Aiding Rupert in his bid for Dow Jones, son James looks likeliest to inherit his mantle

BY RONALD GROVER

WHEN RUPERT Murdoch finally sat down earlier this month with the Bancroft family to discuss his \$5 billion bid for Dow Jones & Co., he knew the meeting was going to be more than a little awkward. The Bancrofts, who control Dow Jones, had publicly expressed concerns that he might meddle with their cherished *Wall Street Journal*.

That the Bancrofts, who had earlier spurned the offer, were now agreeing to meet was a positive sign. But Murdoch still needed to convince them that his intentions were honorable. So he brought along his 34-year-old son, James, who the News Corp. chief hoped would ease the family's concerns. James, who calls his father Pop, sat to his right, soothing and engaging the Bancrofts with tales of growing up Murdoch. "It was clear Rupert wanted his son there," says a person with knowledge of the meeting. "And James carried the ball at key moments."

If the deal goes through—which looks likelier since a potential Microsoft-General Electric joint bid foundered in early June—the Bancroft meeting may be remembered as the moment James Murdoch emerged as one of his father's most influential confidants. The two men get each other on some deep genetic level, say News Corp. insiders, and converse at least twice a day. Will the youngest child inherit the father's throne? It's too early to say since the senior Murdoch, a vigorous 76, shows few signs of relinquishing control. But James, through hard work and canny ma-

neuvering, has won over some of Murdoch Sr.'s veteran lieutenants. "He is just as tough as his old man," says British Sky Broadcasting Group PLC board member and longtime Murdoch ally David Evans.

Not long ago, it looked as though Lachlan Murdoch, not brother James, had cornered the old man's respect. But in 2005, Lachlan, now 35, bolted his job as News Corp.'s deputy chief operating officer, the result of one too many clashes with Fox News Network chief Roger Ailes, a Rupert associate who has long had the boss' ear. Murdoch daughter Elisabeth, who is 38, left the company in 2001 after battling another Murdoch aide, former BSKyB chief Sam Chisholm.

While some considered James the brightest of Murdoch's progeny, he seemed to lack seriousness at first. After just a year at Harvard University studying film and history, he dropped out in 1995 to finance a doomed hip-hop label with a musician pal. James spent most of his evenings then chain-smoking Marlboros and hanging out in nightclubs scouting talent. In those days, he swore so much that his mother, Anna, chastised him for dropping too many F-bombs in a *GQ* interview. Somewhere along the way, James matured; perhaps it was his 2000 marriage to Kathryn, a former model and marketing executive who grew up in Oregon and lives with him in London with their two kids and two dogs.

James was fortunate, perhaps, in that his first big job with the family business involved a stint in News Corp.'s outer rim, Asia, where he got experience away from the 24/7 scrutiny of his father and his aides. Not that the job was a cinch. Sent to Hong Kong in 2000 as CEO of

James' first big Murdoch job, in Asia, spared him much scrutiny from Dad

HEIR APPARENT?

A mile-wide competitive streak, just like "Pop"

ailing StarTV, he helped turn around the money-losing satellite company by forging deals with cable companies in India and then producing an Indian version of *Who Wants to Be a Millionaire* and other hot programs. "Being 12 hours away gave him the freedom to become his own man, make his own decisions," says Abe Peled, CEO of NDS Group, a News Corp.-controlled company that provides anti-piracy software for set-top boxes.

Named CEO of BSKyB in 2003, James pushed the British satellite TV company into broadband and phone service and watched earnings nearly double on a per-share basis. Since then, he has demonstrated Murdochian tactics—blocking rival Virgin Media Inc. from buying British



TV producer ITV and then yanking five Sky-owned channels from Virgin's cable systems. Knowing the move would be unpopular, James went to Sky's Scottish call center to listen in on calls from folks who could no longer get Sky on cable.

DIGITAL STRATEGIST

IN WAYS LARGE AND small, James is his father's son. He's intense, for starters, though where Roop is rumpled, he is polished, with his dark suits, white shirts, and pointy black shoes. Even as a kid, he exhibited dad's competitive hunger: He would switch places at dinner to be served first. And he shares Rupert's laissez-faire politics. "I'd say he's a libertarian," says an associate. "He'd as soon keep the government out."

Battle-tested as an executive, James is now helping reshape News Corp. for the 21st century. It was he who tutored Rupert on the Web, reviewing a 2005 speech in which Murdoch Sr. exhorted newspaper editors to embrace the Web or "be relegated to the status of also-rans." When News Corp. plunked down \$580 million three months later to buy social network site MySpace.com, Rupert did so after huddling with James, who had his own MySpace page.

At a moment when corporations are at least preaching the benefits of environmentalism, James is prodding his father to go green. News Corp.'s May 10 announcement that it would be carbon-neutral by 2010 is modeled on James'

own initiatives at BSkyB that cut carbon emissions 20%, including software that powers down idle set-top boxes.

As Lachlan knows full well, there are no guarantees that James will one day take over. Neither he nor his father will address the succession issue. "There are other good members of the family," Rupert said earlier this year. But speculation is rife in the corridors of News Corp. Here's one theory: If the Murdochs bag Dow Jones, James will return before long to the U.S. as part of an enlarged management team, perhaps to help develop the company's expanded digital push. He made a strong first impression with the Bancrofts. And he has already done so with the one guy who really counts: Pop. ■



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Where the Best Medicine is Data

Drugmakers have come to rely on IMS Health's inside track on the prescriptions doctors write

BY CATHERINE ARNST

IN TODAY'S HEALTH-CARE world, information is power. That puts IMS Health Inc., the world's largest aggregator of prescription data, in a winning position. Big Pharma, government regulators, think tanks, and reporters all turn to IMS to find out how much of a given drug was prescribed in any week, month, or year. None of the information is linked to individual patients, but it's incredibly detailed—right down to the names of the doctors who wrote the scripts.

So it's hardly a surprise, in today's data-obsessed world, that IMS is an irresistible magnet for health-care investors. And recent events suggest it is likely to remain so. The company dodged a bullet in May when a federal judge overturned a New Hampshire law that seemed written specifically to limit

its core business. The law, passed a year ago, restricted the collection of data on an individual doctor's prescribing patterns—the kind of information a pharma company loves to buy, so it can figure out just who its best and worst prescribers are, and deploy sales reps accordingly. IMS sued to block the New Hampshire law, and when a federal judge struck it down on May 1 as an infringement on freedom of speech, IMS stock hit a nine-year high of 31.60.



The shares have stayed at that level ever since, a sign investors think the steady upward march of IMS's earnings over the past three years will continue unabated. It's true that several other states are considering restrictions on prescription data gathering, and Vermont just passed a law making it a little tougher to collect such information on individual physicians. Nevertheless, industry analysts say the New Hampshire

CARLUCCI A recent court ruling has boosted IMS's stock price decision makes it unlikely any state will be able to mount serious opposition to IMS's business practices. "The value of what they do just keeps going up," says John Kreger, who follows IMS for investment advisers William Blair & Co. "Anytime there is a discussion about health-care reform, there is a recognition that we need more data, not less, to make smarter decisions."

DETAILS IN A HURRY

THAT IS THE FIRM belief of IMS Chief Executive David R. Carlucci, who says his company's prospects are not tied to the fortunes of the drug and biotech businesses that are its primary customers. Whether the pharma industry is doing well or poorly, the companies need the data. "They are always looking to become more efficient with their marketing and sales efforts," says Carlucci. "We can help them precisely focus their strategies."

IMS, in business for 53 years, gathers information on 850 million prescription sales transactions every month in 100 countries. There are no rivals with similar global reach, so it's rare that a news story on any particular drug will fail to cite IMS data. Even its ticker symbol is "RX."

IMS numbers give its customers a snapshot of the market, practically in real time. Within days of the recent *New England Journal of Medicine* report that Glaxo-SmithKline PLC's diabetes drug Avandia may increase the risk of heart attacks, Wall Street analysts were citing IMS data showing the drug's sales dropping off.

Carlucci joined IMS as chief operating officer in 2002, took over as CEO in January, 2005, and has presided over nine straight quarters of double-digit revenue growth. Revenues for 2006 grew 12%, to \$1.96 billion, while earnings rose 11%, to \$315.5 million. IMS also has a fast-growing pharmaceutical consulting business, having acquired seven market research companies in the past 2½ years. But its biggest opportunities are overseas, Carlucci says, particularly in emerging markets in Asia. Three years ago, new markets such as China, India, Korea, and Russia contributed 13% of IMS's revenues. By 2006 that had grown to 27%.

Robert W. Baird & Co. analyst Eric Coldwell says IMS presents one of the lowest risks of any of the corporations he follows. "I am incredibly confident in this company and this management," he says. "My only concern is that I have no concerns." ■

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Scrambling to Bring Crest to the Masses

As growth in Chinese cities slows, P&G sets its sights on 700 million rural consumers

BY DEXTER ROBERTS

YOU MIGHT NOT EXPECT Gong Jianchen to be much of a brand aficionado. The 45-year-old father of two drives a truck, delivering pots, pans, and appliances from his hometown of Qiaoliufan, a sleepy little village in northern China where farmers ride their bikes in from the surrounding wheat fields to do their daily shopping. But just ask Gong about his favorite toothpaste or shampoo, and he turns rhapsodic. "Our family buys both Head & Shoulders and Rejoice, and Crest is good for brushing teeth," he says, reaching for the products as he shops. "Quality, at a reasonable price, is most important."

It's no accident that plenty of Procter & Gamble Co. brands have worked their way into Gong's heart. Few U.S. companies have seen the success in China that P&G has enjoyed. Since the Cincinnati-based consumer-products giant first brought Head & Shoulders to the mainland in 1988, it has introduced a steady stream of popular American brands such as Olay, Pampers, and Whisper, racking up \$2.5 billion in annual sales there for fiscal 2006. It has 6,300 workers in China, and the extensive distribution network it needs to prosper in the world's fastest-growing retail market.

While the country's overall economy is booming, though, urban markets are increasingly competitive as the world's top brands vie for share. Meanwhile, growth in retail sales in the countryside is quickly catching up with that in major cities such as Beijing and Shanghai. Overall, just one-third of retail revenues now come from

A pact with Beijing calls for P&G to train locals in 10,000 villages



RURAL ROUTES A truck delivers P&G goods in Qiaoliufan southwest of Beijing

China's 24 largest cities. So in a bid to sustain its torrid expansion, P&G is pushing beyond China's wealthy coastal regions and spending more time and effort selling its soaps and other goods in places like Qiaoliufan. "There is an untapped opportunity to get our products to more consumers in the interior," says Christopher D. Hassall, a P&G vice-president in China.

Winning over rural Chinese, though, can be more complicated than selling to sophisticated city dwellers. Most of the 700 million potential consumers are first-time buyers, and incomes in the countryside average just \$466 annually, less

than one-third the level in mainland cities. What's more, rural China is hardly homogeneous. China's 30-some provinces and regions are home to scores of cultures with vast differences in buying habits. And unlike the country's cities, where shoppers are shifting to big retailers such as Wal-Mart or Carrefour, most rural consumers still buy from tiny mom-and-pop stores.

To make inroads, P&G is sending its advance staff into as many out-of-the-way villages as it can to get a feel for what rural Chinese want to buy and how much they're willing to spend. Just as it has done for years in the cities, P&G's

teams of so-called customer research managers descend on villages, often moving in with families for a few days. They've discovered that while low prices surely help sales, it's equally important to develop products that hew to cultural traditions. Urban Chinese are happy to pay more than \$1 each for tubes of Crest toothpaste with exotic flavors such as Icy Mountain Spring and Morning Lotus Fragrance. But those living in the countryside are apt to prefer 50¢ Crest Salt White, since many rural Chinese believe that salt whitens teeth. P&G applies similar segmenting strategies to its Olay moisturizing cream, Tide detergent, Rejoice shampoo, and Pampers diapers. "P&G is very thorough and calculating [in China]," says Jeongwen Chiang, associate dean of the Cheung Kong Graduate School of Business in Beijing. "They don't blindly duplicate their successes in the West."

Just as important is getting goods

MARK LEONG/REDUX

to rural customers. The household and personal-products behemoth has built a distribution network covering half a million stores in almost all of China's cities and many of its towns. But villages have been largely unserved. Now that's changing. In Gaobeidian, a region an hour and a half southwest of Beijing that includes Qiaoliufan, P&G sells in some 300 shops in 150 villages—or more than half the district's total. It will add an additional 50 shops this year, says P&G sub-distributor Bai Fengwu, who delivers both products and sales aids such as posters and display boxes from his van, which is emblazoned with the logos for Tide, Safeguard soap, Pantene shampoo, and other brands. "We are looking at going deeper and improving our retail presence," says Irwin Chua Lee, vice-president of corporate marketing who oversees the company's sales of fabric and home care products in Greater China.

RIVALS GEAR UP

AN AGREEMENT with China's Commerce Ministry signed in April should help P&G even more. Plans call for the company to help improve existing outlets, build new ones, and train locals in some 10,000 villages in the art of retailing. Beijing likes the plan for its promise to root out counterfeit goods and help spur rural consumption and economic growth. "We want to serve the peasants and bring real benefits to them," says Chang Xiaocun, the ministry official overseeing the project.

P&G's push into the countryside won't go unchallenged. Chinese rivals such as detergent and toothpaste makers NaFine and Nice Group have increased their market shares rapidly, in part by relying on armies of local staff who push their products across China. Meanwhile, Anglo-Dutch consumer giant Unilever has reorganized its once-chaotic China distribution network and is seeing strong growth in brands such as Omo detergent, Zhonghua toothpaste, and Clear shampoo. "We have made some errors and that has made us into a wiser company," says Frank Braeken, Unilever's chairman for greater China.

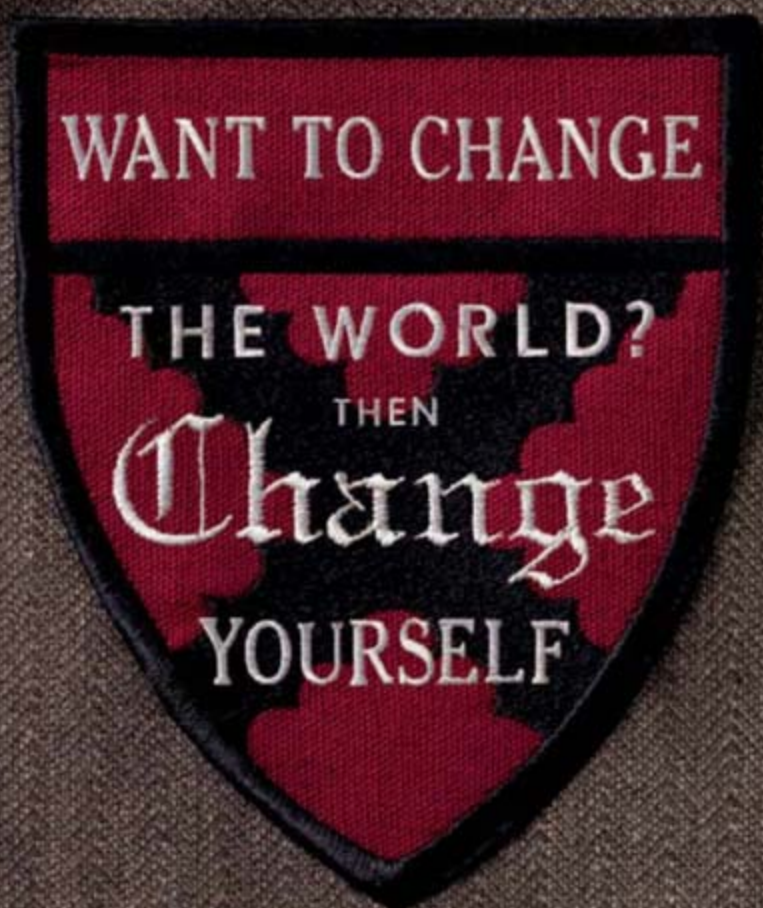
It all adds up to good news for shopkeepers and shoppers alike. "Before we offered just one product to the consumer and they accepted that," says Wang Yongjie, who has run a general store on Qiaoliufan's long, dusty main drag for 25 years. "Now they have a brand in mind when they walk through the door." ■

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MILLER AND ZAPOLIN
The Grateful Dead's site inspired the duo

The Domains Of the Day

How two Boston entrepreneurs are making millions from names as simple as chocolate.com

BY AARON PRESSMAN

THE FACT THAT ANDREW Miller and Michael Zapolin don't speak German was never a problem, until the two Internet investors decided to buy the domain name "chocolate.com." The owner, a man in Germany who didn't speak English, was content to paper the site with ads for chocolate companies and collect pocket change whenever someone clicked on one. But Miller, 42, and Zapolin, 40, saw the chance to make millions. "We knew nobody was doing a good job with chocolate in the online space," says the fast-talking Miller. "And we were imagining how much free chocolate we'd get," jokes Zapolin, a New Age enthusiast who goes by the nickname "Zappy." After weeks of voice mail and e-mail messages, all in English, a lawyer in Atlanta called to say he was representing the man. Within days, they were able to buy the domain for \$300,000—a fraction of the cost of other generic sites.

Two years later, the Boston-based duo has built an online emporium, complete with boutique sweets, recipes, and articles that run the gamut from the health benefits of dark chocolate to the history of chocolate Santas. As with a mall owner, the key was to attract an anchor tenant in the form of *Chocolatier* magazine, which provides articles and recipes to the site. Traffic has so far doubled this year, and the site is on track to clear \$2 million in revenue. Convinced that chocolate.com could become a \$100 million property, they're now turning away would-be suitors.

NAME GAMES

IT'S ANOTHER VICTORY for Miller and Zapolin. Through their company, Internet Real Estate Group, they've made a career of buying underappreciated domain names on the cheap and turning them into multimillion-dollar properties. Instead of flooding a site with pay-per-click ads and flipping the domain for a quick profit, they're trying to develop real businesses that will sell for much more. They own 17 domains, ranging from software.

com to relationship.com, with a closely guarded list of several others they would like to buy—if the price is right.

They work out of a brownstone on Boston's tony Newbury Street but prefer doing business at their local Brigham's ice cream shop. Miller describes himself as the aggressive one who's always hunting for the next big deal. Zapolin is more laid back and focuses on creatively expanding the sites. They met in the late 1980s as sales trainees at the ill-fated junk-bond house Drexel Burnham Lambert, getting together for gambling trips to Atlantic City and later teaming up to produce infomercials. One of their clients, The Grateful Dead, inspired them to get into the domain game with its success in using www.dead.net to sell merchandise and bring together fans.

They bought control of beer.com for \$80,000 in 1998 and built an audience for the site by giving out free e-mail addresses and having fans rate different brews. Less than a year later, they sold it for \$7 million to Interbrew, a beer company. The pair then bought creditcards.com for \$100,000 in 2003, created a comparison site for credit-card offers, and sold it to a private equity buyer for \$2.8 million in 2004. Now that it's valued by some at several hundred million dollars, they admit to selling too soon.

The crux of the business is the domain name. Chocolate.com automatically gets thousands of visitors a day who type the word "chocolate" into the address line of their Web browser instead of a search site like Google. About one in six Internet searchers never goes to a search site, opting instead for direct navigation. The name also helped the site vault ahead of famous names like Hershey's and Godiva in Google searches.

Such advantages help explain why the market for generic domain names is booming. Deals for resold domain names hit \$700 million last year, about double the figure in 2005 and quadruple the 2004 level, according to Sedo, a domain name brokerage and appraisal firm in Cambridge, Mass.

Determined to turn the name of a popular produce into a lucrative business, Zapolin and Miller don't want to sell chocolate.com—yet. The memories of offloading creditcards.com too soon also still rankles, though they laugh it off now. "We're not crying in our soup over credit cards," Zapolin says with a smile over a raspberry lime rickey and a peanut butter and jelly sandwich at Brigham's. "We've got a few more in our portfolio." ■

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Up from The Onion Fields

An immigrant's startup has a plan to cut pollution in ports

BY CHRISTOPHER PALMERI

RUBEN GARCIA CAME to the U.S. from Mexico when he was three, squeezed into a station wagon with his mother, stepfather, and nine siblings. The family settled in California's Central Valley, where Garcia and his brothers picked onions, carrots, and potatoes after school. Says Garcia, who still can't stand onions: "Once you've worked on a farm like I did, you never want to go back."

Garcia no longer has to break his back in the sun. The company he founded, Advanced Cleanup Technologies Inc. in Rancho Dominguez, Calif., has a lucrative niche cleaning up after industrial accidents. Garcia's business employs 250 people and has doubled in size in the past five years. Last year, Garcia netted \$8 million on sales of \$40 million.

Now Garcia has invested \$8 million in a risky new venture aimed at reducing air pollution from idling ships and trains at ports and railroad terminals. With towns near Long Beach harbor complaining of the rising number of young children with asthma, Garcia says, "It's an ongoing problem, and it's killing people."

Garcia got his start in business right after high school, when he began working at his dad's hazardous waste transport company. Garcia saw that federal regulations passed after the *Exxon Valdez* oil spill would require specialized workers to clean up after industrial accidents. Borrowing \$8,000 from one of his father's customers, he bought a used vacuum

GARCIA Inside the hood of his particulate-cleaning machine

truck—a big wet/dry vac on wheels—at a city auction in 1992. Two years later, he won a contract to clean up after an oil pipeline burst in the Northridge earthquake, putting his company on the map.

Although tighter safety regulations have resulted in fewer major industrial accidents, Garcia's company still handles more than 600 projects a year, from dredging sludge from the bottom of a Disneyland lagoon to helping clean up New Orleans after Hurricane Katrina. Even smaller accidents, such as a spill of just a few gallons of gasoline, can mean sending workers in protective suits into storm drains to pressure-wash pipes. "You find all kinds of things down there," Garcia says. "Shopping carts, dead animals, people." Garcia's wife, Tammy, flies a company helicopter during offshore projects to guide the crews below.

SCRUBBED EXHAUST

GARCIA GOT INTERESTED in air pollution after hearing complaints about air quality at the ports of Long Beach and Los Angeles. Ships run their auxiliary diesel engines while they're in port, enabling them to operate cranes and lights but spewing harmful nitrous oxide, sulfur dioxide, and particulates into the air. Garcia designed a device that captures exhaust in a rigid fabric hood, then

cleans it with scrubbers made by other companies. As he was pitching his idea to ports, an environmental regulator from Placer County, Calif., suggested testing it at Union Pacific Corp.'s railway yard there. It cut emissions by 97%.

The price tag is steep: \$8 million for a version that can clean exhaust from several ships at once. The alternative is to rewire ships so they can run on electricity from the mainland grid. That would cost about \$1 million per vessel but would require investment by ship operators.

The ports of Long Beach and Los Angeles are likely to become test cases for Garcia. Those ports are requiring operators to cut emissions by 50% over the next five years, and Robert Kanter, chief environmental officer for the Port of Long Beach, says Garcia's device is one of a few serious contenders. Metropolitan Stevedore Co., a terminal operator in Long Beach catering to ships that come to port infrequently, has agreed to buy one of Garcia's scrubbers if it works in a test run this summer. "It solves a lot of problems for vessels that do not call on a regular basis," says Albert J. Garnier, the company's chief operating officer. "I saw it as a little bit of a silver bullet."

This summer will mark another milestone for Garcia, when he becomes a U.S. citizen some 14 years after receiving his green card. Says Garcia: "It'll be one of the happiest days of my life." ■

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How to Avoid the Big Squeeze in the Sky

Too close for comfort in coach? Try premium economy class. **BY GREG LINDSAY**



PASSENGERS WHO FLY coach are used to the no-frills wasteland in the back of the (Air)bus. But a handful of carriers now offer a premium economy tier priced between the lie-flat beds of the business cabin and the ramrod-straight seats of cattle class.

Depending on the airline, premium-economy-style seating can include a few inches of extra legroom or a significantly wider, leather seat in a dedicated cabin for as little as one-third of the business-class fare between New York and London. Perhaps best of all for travelers fearful of inciting cost-conscious accounting departments, premium economy shows up as coach on expense reports. Here are our picks for the best premium economy programs:

1. VIRGIN ATLANTIC AIRWAYS invented the service back in 1992, with the introduction of Mid Class, now called Premium Economy, aboard its transatlantic flights. The

carrier overhauled its premium economy cabins last year, introducing 21-inch-wide purple-leather seats—just an inch narrower than in its vaunted Upper Class—and 38 inches between your seat and the one in front of you (six inches more of so-called seat pitch than in coach). Passengers receive preflight champagne and higher-quality meals and amenity kits than in coach. They're also allowed to check in and board with the Upper Class cabin (although they aren't invited to kick back in Clubhouse lounges beforehand). A recent midweek round-trip Mid Class fare between New York and London was \$2,362, about \$5,719 less than an Upper Class ticket.

2. BRITISH AIRWAYS' World Traveler Plus cabin is not as roomy as Virgin's latest iteration, and there's no priority check-in and boarding. But it offers dedicated meals, amenity kits, in-seat power outlets, and 38 inches of pitch. BA is thinking of launching flights with

a mix of just business-class and premium economy seats from continental Europe to New York next year.

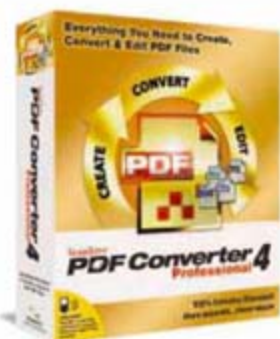
3. UNITED AIRLINES' Economy Plus lacks the frills (and wider seats) of Virgin or BA, but it is the most affordable premium-economy seat in the sky. For just \$299 a year, you can get an automatic upgrade from coach every time you fly. (Elite members of United's Mileage Plus loyalty programs are offered complimentary upgrades as well.) Passengers receive only four inches or so of extra legroom, but that can make the difference between a few comfortable hours with a laptop and a flare-up of carpal tunnel syndrome.

4. MIDWEST AIRLINES is justly famous for the comfy leather seats and warm chocolate chip cookies of its Signature Service aboard its fleet of Boeing 717s. Flying mostly out of hubs in Milwaukee and Kansas City, Midwest built its reputation on the wide 21-inch seats that trump every competitor on routes across the heartland. A recent Milwaukee-to-Denver flight on Midwest was \$473 round-trip, about the same as on Frontier and United. As part of an effort to add capacity, Midwest will pack regular coach seats on all of its flights from now on, but passengers willing to pay a little more can still snag the wider seats and the cookies.

5. ALL NIPPON AIRWAYS offers the only premium economy service within Asia. The seats, similar in pitch and width to BA's, are available on long-haul flights in and out of Tokyo and on ANA BusinessJet flights aboard modified 737s from Nagoya to Guangzhou and Tokyo to Mumbai. ANA expects to include premium-economy seats on its Boeing 787 Dreamliners, which the airline will be the first to fly next year on routes it has yet to announce. ■

HARRY CAMPBELL

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BY ROBERT PARKER

A Rhône Valley Tale With a Happy Ending

MAISON M. CHAPOUTIER, located in the quaint northern Rhône town of Tain l'Hermitage, was founded in 1808. With just under 200 acres, it is a huge landholder by Rhône Valley standards. For many years the business muddled along, producing irregular and largely indifferent wines. When Max Chapoutier retired in 1989, his energetic, brilliant young son Michel took charge. Michel introduced "biodynamic farming," banning the use of chemicals and relying on organic techniques to cultivate the grapes.

Michel's moves led to a dramatic jump in quality for Chapoutier wines. Here are some of my favorites from the 2005, 2004, and 2003 vintages, the ones you're most likely to find on store shelves or restaurant wine lists.

2005 Côtes-du-Rhône Belleruche (white)

87 points. This blend of grenache blanc, bourboulenc, and marsanne shows honeysuckle, lemon oil, and white currants in a medium-bodied, crisp, attractive, surprisingly serious style. \$8-\$10

2005 Côtes-du-Rhône Belleruche (red)

86 points. Made from 80% grenache and 20% syrah, this wine offers some herbal notes, dark ruby color, good fruit, medium body, and a straightforward style. \$8-\$13

2005 Crozes-Hermitage Les Meysonnieres (white)

88 points. The lemony, apricot, and pear-like notes of this crisp, medium-bodied, zesty and fresh wine are well-presented. Don't wait too long to drink it. \$17

2005 Crozes-Hermitage Les Meysonnieres (red)

87 points. The aroma of sweet and sour

ORGANIC INFLUENCE
Michel Chapoutier's ban on chemicals led to better wines



cherries, olives, licorice, and smoke appear here. Dark ruby, the wine exhibits crisp acids and a spicy, heady finish. \$20

2004 Hermitage Chante-Alouette

94 points. This white has wonderful notes of honeysuckle, licorice, quince, and white currants in an almost thick, juicy style that is buttressed by considerable acidity. It is a gorgeous wine with terrific intensity and richness. \$54

2004 Châteauneuf du Pape Barbe Rac

93 points. Displaying a deep ruby hue, this cuvée is a classic Châteauneuf du Pape, offering superb aromas of roasted herbs, licorice, ground pepper, and sweet black

cherry fruit. It tips the scales at over 16% alcohol but doesn't show it, which is a tribute to the ancient grenache vines that produced it. Deep, full-bodied, and opulent, this wine is best enjoyed during its first 15 years of life. \$66-\$79

2004 Ermitage Cuvée de l'Orée

99 points. White currants and quince light up the golden 2004 Ermitage Cuvée de l'Orée. This is a fabulous wine, with blockbuster intensity and richness. It is the kind of wine that with proper storage may last 50 or even 100 years, but I'm sure most of it will be consumed a whole lot sooner. \$149-\$161

2003 Côte Rôtie La Mordorée

96+ points. The dense, purple-hued La Mordorée reveals a sumptuous perfume of new saddle leather, barbecued meats, herbs, black raspberries, and crème de cassis. This stunningly concentrated, full-bodied, rich wine takes Côte Rôtie to a new quality level. It can be drunk young or cellared for 15 to 20-plus years. \$188-\$200.

Robert Parker is the world's most influential wine critic. Visit eRobertParker.com to see tens of thousands of tasting notes, buy his books, or subscribe to his newsletter, The Wine Advocate.

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Taking the Middle Way

Midcaps are outpacing bigger rivals yet are less risky than small-cap companies. **BY AARON PRESSMAN**

MUTUAL FUND INVESTORS STARTED 2007 as they had the last few years—debating whether to move money into large-cap stocks or keep their bets on small caps, which have beaten the blue chips seven years running. While everyone was focused on the big and the small, stocks in the middle have actually turned in the best performance so far this year. Funds specializing in midcap stocks, those companies typically with a market capitalization of \$2 billion to

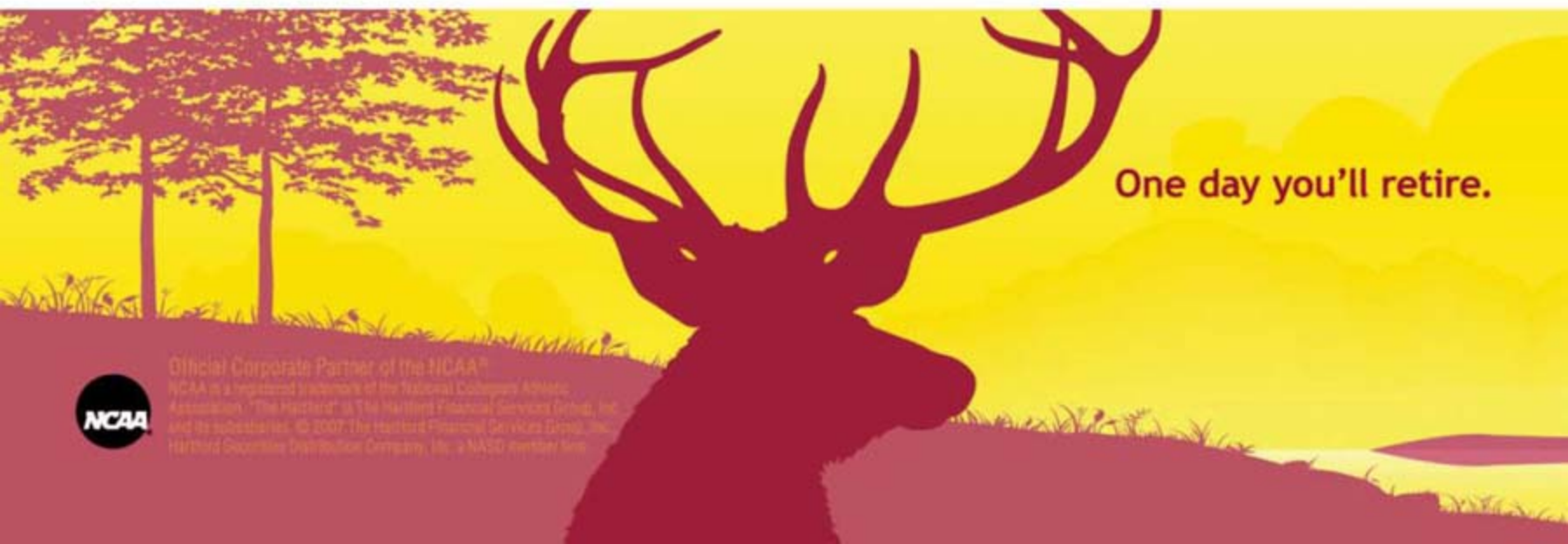
\$20 billion, have risen 11% since January, beating the 8.4% gain in small-cap funds and 7.6% return on large-cap funds, according to Morningstar. Among midcaps, growth-oriented funds have done best, advancing 11.5%, vs. 10.2% for midcap funds that focus on value stocks.

What's behind the surge? Midsize companies are the place to be when

economic growth and corporate profits are slowing. Because of their size, they're able to grow faster than larger competitors, yet they're financially sturdier than the small-cap companies. Some of it has been luck, too. As a percentage of the index, the Standard & Poor's MidCap 400 has about twice the weighting in basic materials and utilities stocks as the S&P 500-stock index, and both sectors

have been hot this year. Investors have taken notice. They pumped \$8 billion into midcap funds in the first quarter, up from \$3 billion for all of 2006, according to market tracker Financial Research.

The midcaps' prospects seem bright. While analysts forecast that operating profits at companies in the S&P 500 will increase 20% over the next two years, those for members of the S&P MidCap 400 will jump 32%. Small-cap earnings are projected to rise 29%, but profits at those companies could be jeopardized if the economy slows sharply. "With small



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caps, you're either going 80 miles an hour or you're crashing," says Arie Coll, manager of the Eaton Vance Tax-Managed Multi-cap Opportunity Fund. "The odds of an accident with midcaps are greatly reduced."

Investors should aim to have about 25% to 30% of their U.S. equity allocation in midcaps, according to Brett Hammond, chief investment strategist at TIAA-CREF. That's about what you would find in the broadest market indexes, such as the Russell 3000 or Wilshire 5000, so funds based on those indexes

are one way to take a stake in the midcap sector. There is no shortage of mutual funds specializing in midcaps, either. (View them on the BusinessWeek Mutual Fund Scoreboard at bwnt.businessweek.com/mutual_fund/.)

THE GRADUATES

THE MIDDLE OF THE market has benefited indirectly from the seven-year small-cap rally. Many of the best small companies have seen their market value appreciate so much that they've graduated to midcap status. "The cream has

risen to the top," says Daniel Thelen, a small-cap and midcap stock manager at Loomis Sayles in Boston. At the end of May, for example, S&P promoted three top-performing companies to its MidCap 400 index. Five years ago, Digital River, Endo Pharmaceuticals, and Equity One had market caps of under \$1 billion. But after gaining 630%, 224%, and 86%, respectively, they've climbed to an average market cap of \$2.8 billion.

The mergers-and-acquisitions boom has also contributed. Private equity funds raised almost \$250 billion last year, and midcaps make a good hunting ground for them. Most small-cap companies don't interest the big funds as acquisition targets while megacaps remain out of reach for the most part. Companies such as Duquesne Light and Claire's Stores had to be removed from midcap indexes in May because of takeovers.

There are few signs to suggest the midcaps are overheating. Earnings have risen faster than stock prices, so the price-to-earnings ratio of Russell's midcap index, 26 at the end of May, was actually two points lower than where it stood three years ago. Jeff Parker, chief investment officer for growth funds at Allianz Global Investors, says the midcaps' strong momentum should keep them in the lead for a while. "With midcaps," says Parker, "you get the best of all possible worlds." ■

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ONLINE: Find the best rated midcap funds by visiting BusinessWeek Mutual Fund Scoreboard at bwnt.businessweek.com/mutual_fund/

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Is Your Portfolio Thriving?

Stock funds keep soaring, but the bond market is a bummer

BY LAUREN YOUNG

WHAT IF 2007'S FIRST half ended right now? Stock-fund investors would be all smiles. Even with a good drubbing in June, most domestic equity mutual funds are posting positive gains for 2007 (through June 11). The average U.S. stock fund delivered an 8.06% total return (appreciation plus reinvestment of dividends and capital gains before taxes), vs. 7.28% for the Standard & Poor's 500-stock index.

International funds are doing even better. The typical diversified foreign portfolio has a 9.18% return. And funds that focus on the emerging markets, especially Latin America, are leading the way.

But investors in fixed-income funds have not fared well. Signs of inflation have spooked the bond market, with long-term bond funds losing the most ground in the past month. Most municipal bond funds—short or long, national or single-state—are also down for the year.

Overall, the typical taxable bond fund is up a mere 1.16% in 2007, while the Lehman Brothers Aggregate Bond index gained 0.31%. So much for finding safety in the fixed-income market. At this rate, bond portfolios might be posting big losses by yearend. ■

NATURAL RESOURCES With oil prices once well above \$60 a barrel, and gasoline north of \$3 a gallon, what else would you expect?

TECHNOLOGY It's not 1999 all over again, but tech funds are logging market-beating returns. Top holdings include big names such as Google, Cisco, and Qualcomm.

LARGE-CAP GROWTH After seven years of trailing small caps, large-company stocks are still struggling to get ahead. Even so, the sluggish economic environment favors big over small.

LONG-SHORT These hedge-fund wannabes are hot. There are more than 50 of them now, with assets of \$20 billion.

REAL ESTATE They hold mainly real estate investment trusts, and were in the black for the year until the early June sell-off. Investors have yanked \$1 billion out of them in the past month.

BEAR MARKET It has been tough to be a bear this year—until now. The recent downdraft cut these funds' 2007 losses by a third. If Wall Street continues to wither, they'll look pretty smart.

LATIN AMERICA They're soaring, thanks to the commodities boom. But watch out: Latin funds have suffered double-digit losses in 22 three-month periods in the past decade. If that's too much, do your Latin investing through a diversified fund.

PACIFIC/ASIA EX-JAPAN The funds lost 5% when the Asian markets plunged in February. But they've gained more than 18.2% in the past three months, even with continued turmoil in Chinese stocks.

FOREIGN LARGE-CAP GROWTH They're pulling back a bit, but these foreign blue chips are still besting their U.S. counterparts. A weak dollar is helping.

Stock Funds

DOMESTIC	TOTAL RETURN*
Natural Resources	17.04%
Communications	12.66
Utilities	11.61
Mid-cap Growth	11.47
Mid-cap Blend	10.89
Mid-cap Value	10.19
Small-cap Growth	9.18
Technology	8.47
Small-cap Blend	8.24
Large-cap Value	7.78
Large-cap Growth	7.74
Large-cap Blend	7.41
Small-cap Value	7.19
Health	6.40
Long-Short	4.34
Financial	2.36
Real Estate	-0.64
Bear Market	-5.91
BALANCED	
World Allocation	5.74
Moderate Allocation	5.29
Conservative Allocation	3.05
INTERNATIONAL	
Latin America	22.72
Pacific/Asia ex-Japan	16.44
Diversified Emerging Mkts.	13.33
Foreign Small/Mid Growth	12.48
Foreign Small/Mid Value	11.26
Diversified Pacific/Asia	10.99
Foreign Large-Cap Value	9.12
World	9.03
Europe	8.94
Foreign Large-cap Growth	8.85
Foreign Large-cap Blend	8.57
Precious Metals	1.26
Japan	1.17

* Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1–June 11, 2007

Data: Morningstar Inc.

Checkup

Any Subprime Surprises?

Most bond funds—but not all—saw the trouble coming

BY DEAN FOUST

AS DEFAULTS OF subprime mortgages continue to rise, it turns out that the affected homeowners and their lenders aren't the only ones hurting. A handful of bond funds got nicked, too. The good news: It appears the damage is limited, with the majority of fund managers having presciently dumped their subprime securities last year or at least limited their exposure. "Fund managers were on to this problem well ahead of the media," says Jeff Tjornehoj, a senior research analyst at Lipper Inc., a New York fund analysis service.

Among those licking their wounds are the \$1.6 billion Fidelity Mortgage Securities Fund, which returned just 0.21% through June 11. That's nearly a full percentage point below the performance of all taxable bond funds but slightly ahead of the 0.19% return of the intermediate-bond category, its peer group. It had 18% of its portfolio in collateralized mortgage securities as of Feb. 28, its last report. Regions Morgan Keegan Select High Income Fund did better, with a modest 0.69% return. The \$1.16 billion fund has roughly 14% of its portfolio in subprime asset-backed securities. Fund manager James C. Kelso Jr. says he's still holding on to his subprime positions because he believes the sell-off was overdone. "Most of what we're holding is [loans underwritten] between '03 and '05," when

CONVERTIBLES With their fortunes linked to equities, these bonds shine when stocks are strong. The leader is Fidelity Convertible Securities Fund, up 13.84%.

HIGH YIELD Returns are good, but credit analysts warn this sector is in for a fall. Half of fund assets are rated a dicey "single B."

EMERGING MARKETS These funds often own higher-quality, dollar-denominated sovereign debt, but plenty of them are getting a kick from local-currency bonds, which rallied as the greenback fell. If the dollar strengthens, they'll suffer.

ULTRASHORT With only a bit more risk than the average money-market fund, but they have outperformed money funds in eight of the past 10 years. This year, they're lagging the money funds, thanks to climbing interest rates.

MULTISECTOR These invest-anywhere funds are now holding big stakes in lower-quality and foreign-currency bonds.

LONG GOVERNMENT Held to maturity. Treasuries are safe. But while you're holding them, interest-rate moves can change values dramatically. In the last four weeks, the group lost 5%. Ouch.

Bond Funds

	TOTAL RETURN*
Convertibles	6.48%
High Yield	3.95
Bank Loan	3.43
Emerging Markets	2.32
Ultrashort	1.87
Multisector	1.77
Short-Term	1.30
Short Government	1.08
Muni. National Short	0.78
Inflation-Protected	0.40
High-Yield Muni	0.40
World Bond	0.21
Intermediate-Term Bond	0.20
Intermediate Government	0.05
Muni. Single-State Short	-0.01
Muni. National Interm.	-0.35
Muni. Single-State Interm.	-0.39
Muni. Single-State Long	-0.47
Muni. National Long	-0.49
Long-Term	-0.94
Long Government	-3.83

* Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1–June 11, 2007

Data: Morningstar Inc.

subprime lending standards were much stronger, says Kelso. "These things go in cycles."

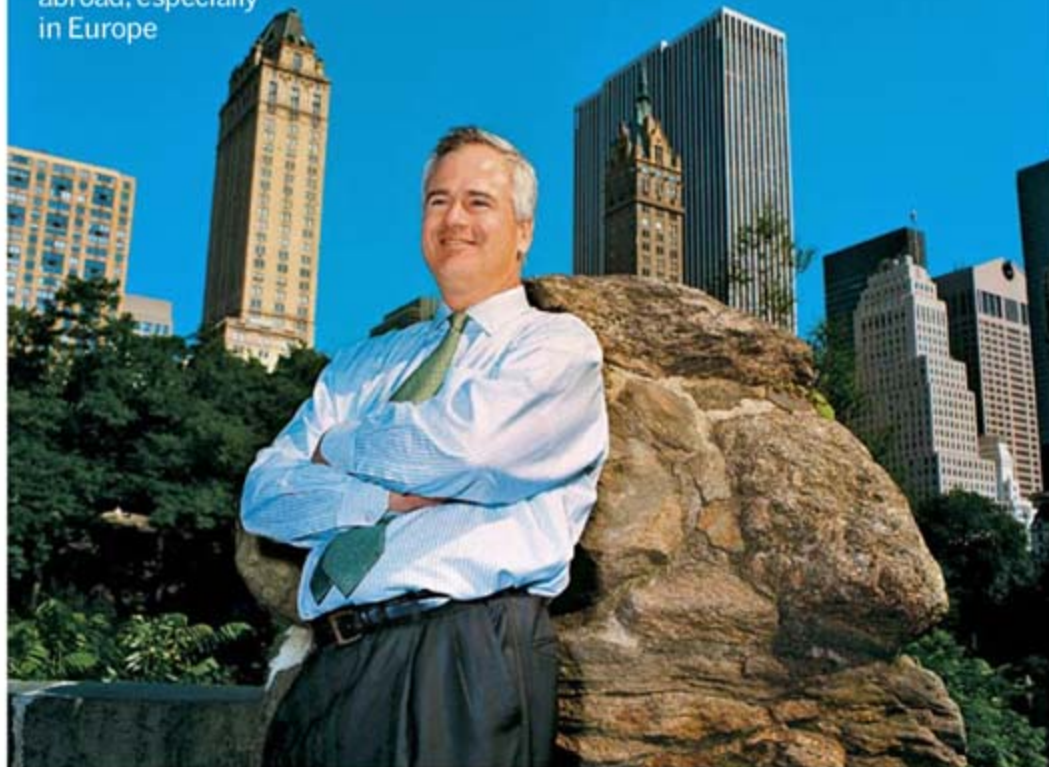
A few funds tried to turn the meltdown to their advantage. Case in point: Late last year, the managers of the Dreyfus Premier Core Bond Fund bought derivatives that would rise in price if subprime asset-backed securities declined in value. That bet paid off. The fund generated a 0.74% return through June 11.

Still, some analysts worry that the subprime mess could worsen, in part because of rising defaults and in part because some funds are holding collateralized debt obligations. What's more, the stated price

of these complex baskets of mortgage-backed securities may not truly reflect the impact of those defaults.

It's not easy to determine how much subprime exposure is in a fund. Checking the holdings (sec.gov, click on "Edgar") may not help, since many mortgage securities have generic names—Fremont Trust 2005-2 N3, for instance—that don't reveal their credit quality. Easier to spot are securities created by such subprime lenders as Countrywide Financial, New Century Financial, or NovaStar Financial. If anything, the complexity of these securities suggests investing in them is best left to pros. ■

McMANUS Fund investors have reason to look abroad, especially in Europe



Going with the Flow of the Funds

BofA's Thomas McManus on how mutual funds help him peer into the market's future

EVERY STOCK MARKET GURU has a pet indicator. Some focus on mortgage rates, the U.S. money supply, or even the price of a Big Mac. For Thomas McManus, chief investment strategist at Bank of America, it is the cash flowing into and out of mutual funds. McManus pays careful attention to this info to get a fix on investor sentiment, potential investment bubbles, and overall market trends. Personal Finance Editor Lauren Young spoke to McManus to decode the fund flows.

What do you learn from fund flows?

Mutual fund flows help us identify those worrisome moments when investors fall head over heels for a particular sector. Just look at the tech bubble. In the five months from November, 1999, to March, 2000, \$47 billion went into technology funds. By the end of March, tech-fund assets hit \$163 billion. So one-third of the

assets in these funds had been invested for six months or less. That indicates how the crowd can be really wrong at major inflection points.

Technology funds haven't seen any significant inflows for several years. Is tech a good place to be right now?

Overlooked sectors can be a good area

for investment, but they need a catalyst. There's none in tech right now. As a strategist, I try to identify the intersection of expectations and reality.

Do you worry that there's a bubble in international stock funds?

International funds have attracted more than \$70 billion in new cash this year. While total assets of international funds relative to all equity funds have gone from 12.5% in 2002 up to 23.5% this year, I'm not worried. There are plenty of good reasons to be looking overseas, particularly in Europe, where companies have gotten their acts together in terms of governance and management.

Even so, I keep my eyes on certain fund families, such as Dodge & Cox, which operates a \$38.5 billion international fund. The company closes funds to new investors when investment ideas are limited, but the fund is still open.

Are cash flows to exchange-traded funds a better market indicator than mutual fund flows?

Because they are actively traded, ETF flows are often temporary and unlikely to signal any real shift in sentiment.

Are investors finally shifting away from small-cap funds to large-cap funds?

Investors are still in love with these smaller-cap funds, and many don't realize the party is over. We've seen weak employment and chain store sales reports. Smaller companies that depend on rapid economic growth are at risk.

Large-cap growth companies haven't garnered much interest yet from investors, even though they have some attractive characteristics. Big companies tend to have greater international exposure and more borrowing capacity. That gives them an edge over smaller companies.

Fund managers aren't holding a lot of cash right now. What does that tell you?

On average, the typical U.S. stock fund has a mere 3.6% cash position, vs. the long-term average of 5%. But the fund industry has changed in the past decade. Portfolio managers today are not expected to anticipate the ups and downs of the market by holding more cash or less cash, so cash positions aren't the best indicator of their sentiment. The sell-off earlier this year also gave managers an opportunity to put money to work. However, cash is meant to be a cushion when funds have redemptions, and fund managers now seem a little bit less prepared than usual for potential weakness. ■



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Ford Mustang, Lincoln Mark LT, Lincoln MKZ, Mazda MX-5 Miata and Mercury Milan received the lowest number of problems per 100 vehicles among midsize sporty cars, large premium multi-activity vehicles, entry premium cars, compact sporty cars and midsize cars, respectively, in the proprietary J.D. Power and Associates 2007 Initial Quality StudySM. Study based on responses from 97,390 new-vehicle owners, measuring 250 models and measures opinions after 90 days of ownership. Proprietary study results are based on experiences and perceptions of owners surveyed in February-May 2007. Your experiences may vary. Visit jdpower.com.



BY GENE G. MARCIAL

THE STREET IS UPDATING ITS PICTURE OF EASTMAN KODAK.

BIO-REFERENCE IS GROWING FAST IN CLINICAL TESTING.

MORE DOGS AND CATS NOW GO TO THE VET AT VCA ANTECH.

Kodak: Set to Click?

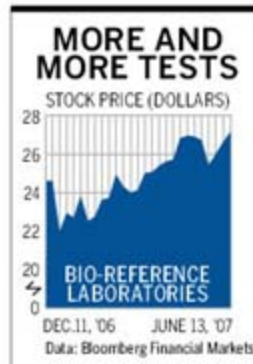
EASTMAN KODAK (EK) is in a bind: Once a blue-chip highflier, it has become almost a pariah on the Street. Six of the 10 major analysts rate it a "sell," and the rest say "hold" or "neutral." Disappointing sales and earnings due to fierce competition from such rivals as Sony and Canon and high costs from turnaround efforts have soured the Street on Kodak. Yet the stock has rebounded this year, zooming from 18 in August, 2006, to 27.01 on June 13, near its 52-week high. One of its biggest fans is top fund manager Bill Miller, whose Legg Mason Capital Management owns a 24% stake. Other Kodak bulls: Brandes Investment Partners with 12%; Private Capital Management, 10%; and Templeton Global Advisors, 8%. Most of Kodak's woes stem from hefty restructuring costs, related to plant closings and the sale of its health-care business. But by 2008 those costs will be in the past, so the bulls expect huge free cash flow for Kodak. Gregory MacArthur of investment adviser Viewpoint 2000 says most analysts haven't factored Kodak's possible upturn in 2008 into their estimates. As more investors get interested in big-cap laggards, this is a chance to get into Kodak, says MacArthur, who values the stock at 32. Kodak expects to finish moving its photo products to digital by 2008, and it is betting on major inroads in the commercial printing business, notes Morningstar in a report. Thomson First Call consensus forecasts are for earnings of 47¢ a share in 2007 and 82¢ in 2008, vs. 51¢ in 2006.



Good Results At Bio-Reference Labs

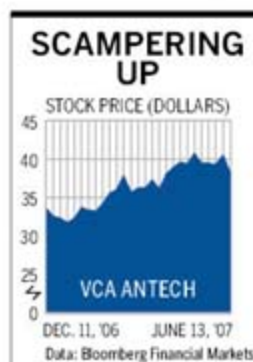
SPECIALTY TESTING is delivering solid earnings for Bio-Reference Laboratories (BRLI), the third-largest U.S. clinical test outfit. "The good news is likely to continue," says Graham Tanaka, manager of Tanaka Growth Fund (it owns shares), because of new contracts with UnitedHealth Group and other health-care providers, as well as the rise in women's health and cancer diagnostics. Bio-Reference's growing "esoteric" testing covers oncology, genetics, toxicology, and immunology, and brings in 40% of revenues, which were \$218 million for the fiscal year ended Apr. 30. "Continued double-digit growth in its core blood testing, plus

a 50% leap in cancer diagnostics, should fatten profits," says Tanaka. He sees earnings of \$1 a share in 2007, compared with a consensus estimate of 96¢ for the year ending Oct. 31, 2007. For 2008, he sees \$1.30, vs. the Street's \$1.22. Last year earnings were 84¢. Arthur Henderson of Jefferies Group, who rates the stock, now at 27.04, a buy, says Bio-Reference is "well positioned for long-term growth."



Why VCA Antech's Tail Is Wagging

TAINTED PET FOOD from China caused a spike in the demand for animal health care, and that has been a boon to VCA Antech (WOOF), the largest operator of U.S. veterinary clinics. It has 376 clinics and 33 diagnostic testing labs. There was "a short-term gain from the China pet food issue," says Robert Mains of Morgan Keegan, who rates the stock "outperform." But VCA's long-term appeal, he adds, is the overall rise in demand for diagnostics and preventive medicine for pets. The sizzle, Mains says, is in the surge in lab tests, which are big profit generators. He forecasts earnings of \$1.38 a share in 2007 and \$1.61 in 2008, up from 2006's \$1.17. The stock has been on a tear, vaulting from 28 a year ago to 38.37 on June 13. VCA recently bought Healthy Pet, which operates 44 animal hospitals in 10 states, with 150 vets on staff. Michael Cox of Piper Jaffray says the acquisition made "good strategic and geographic sense." Even after the buy, VCA represents less than 2% of the 25,000 total U.S. vet clinics, he notes. Cox rates VCA "outperform" with a 12-month stock price target of 46. ■



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Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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STOCKS



COMMENTARY

It was a roller-coaster week for the markets, which ultimately ended up right where they started. Stocks tumbled after 10-year bond yields hit 5.25%, but they later rallied on surprisingly good retail sales and a less-than-gloomy outlook in the Fed's Beige Book. After cutting prices on chips, Intel rose 5.5%. Worries over the iPhone knocked Apple off 5%.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	JUNE 13	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1515.7	-0.1	6.9	23.9
Dow Jones Industrials	13,482.4	0.1	8.2	25.9
NASDAQ Composite	2582.3	-0.2	6.9	24.6
S&P MidCap 400	899.7	-1.0	11.8	25.5
S&P SmallCap 600	431.9	-0.9	8.0	22.4
DJ Wilshire 5000	15,259.1	-0.3	7.3	24.4

SECTORS

	JUNE 13	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	867.9	-0.3	8.7	26.7
BW Info Tech 100**	477.1	-1.3	6.6	34.9
S&P/Citigroup Growth	694.1	-0.3	6.4	22.2
S&P/Citigroup Value	820.4	0.1	7.3	25.5
S&P Energy	526.1	0.1	15.5	40.1
S&P Financials	503.1	0.4	1.6	18.6
S&P REIT	194.0	-2.9	-2.4	18.4
S&P Transportation	281.3	-0.5	6.6	7.4
S&P Utilities	201.8	-0.8	8.1	24.6
GST Internet	217.2	-3.0	8.7	32.7
PSE Technology	943.0	-0.1	7.7	22.8

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	JUNE 13	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	2142.1	-2.5	7.7	38.7
London (FT-SE 100)	6559.6	0.6	5.4	18.8
Paris (CAC 40)	5934.3	-0.7	7.1	28.5
Frankfurt (DAX)	7680.8	-0.6	16.4	45.1
Tokyo (NIKKEI 225)	17732.8	-1.7	2.9	24.7
Hong Kong (Hang Seng)	20,578.8	-1.2	3.1	35.1
Toronto (S&P/TSX Composite)	13,859.5	-0.6	7.4	27.1
Mexico City (IPC)	31,884.1	0.6	20.6	91.5

FUNDAMENTALS

	JUNE 12	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.79%	1.74%	1.92%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.5	18.0	16.6
S&P 500 P/E Ratio (Next 12 mos.)*	15.3	15.8	13.7
First Call Earnings Revision*	0.77%	0.37%	0.64%

*First Call Corp.

TECHNICAL INDICATORS

	JUNE 12	WEEK AGO	YEAR AGO
S&P 500 200-day average	1415.9	1410.7	Positive
Stocks above 200-day average	66.0%	76.0%	Neutral
Options: Put/call ratio	0.96	0.79	Positive
Insiders: Vickers NYSE Sell/buy ratio	5.68	5.42	Negative

BEST-PERFORMING GROUPS

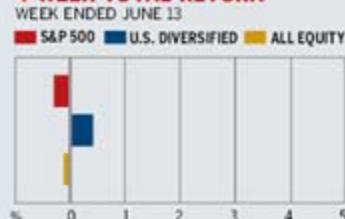
	LAST MONTH %		LAST 12 MONTHS %
Divsfd. Metals & Mining	12.1	Tires & Rubber	213.6
Health-Care Supplies	12.1	Divsfd. Metals & Mining	113.1
Photographic Products	10.9	Internet Retailers	72.9
Internet Retailers	9.9	Constr. Materials	65.8
Oil & Gas Exploration	8.4	Fertilizers & Ag. Chems.	62.5

WORST-PERFORMING GROUPS

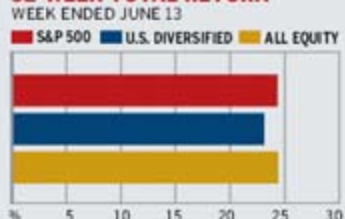
	LAST MONTH %		LAST 12 MONTHS %
Retail REIT's	-11.1	Gold Mining	-16.8
Home Furnishings Rtlrs.	-8.5	Education Services	-10.8
Industrial REIT's	-7.8	Agricultural Products	-9.6
Leisure Products	-7.7	Electric Mfg. Svcs.	-7.5
Office REIT's	-6.6	Airlines	-5.5

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	4.3	Latin America	97.7
Natural Resources	2.1	Pacific/Asia ex-Japan	58.0
Communications	2.1	Diversified Emerging Mkts.	53.6
Pacific/Asia ex-Japan	2.0	Europe	39.7
LAGGARDS		LAGGARDS	
Utilities	-4.5	Japan	12.1
Real Estate	-4.4	Domestic Hybrid	16.0
Precious Metals	-2.3	Financial	17.5
Europe	-2.2	Health	18.1

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProShares Ultra Utilities	16.0	DireXn. Lat. Am. Bull 2X Inv.	204.2
DireXion HCM Freedom	10.1	ProFunds UltraEmrg. Mkts.	137.0
ProShrs. Ultra Real Estate	9.7	DireXn. Emrg. Mkts. Bull 2X	109.7
ProFds. Mble. Tlcms. Inv.	8.4	Dreyfus Prem. Grtr. China A	103.7
LAGGARDS		LAGGARDS	
ProShares Ultra Utilities	-14.4	ProFunds Ultra Emrg. Mkts.	-65.6
ProFds. Utilities UltraSector	-10.9	DireXn. Emrg. Mkts. Short	-61.3
ProShares Ultra Real Estate	-10.3	DireXn. Sm. Cap Bear 2.5X	-41.6
John Hancock Intl. A	-10.0	DireXn. Dev. Mkts. Bear 2X	-41.3

INTEREST RATES

KEY RATES

	JUNE 13	WEEK AGO	YEAR AGO
Money Market Funds	4.86%	4.86%	4.54%
90-Day Treasury Bills	4.65	4.79	4.91
2-Year Treasury Notes	5.07	4.95	5.01
10-Year Treasury Notes	5.20	4.97	4.96
30-Year Treasury Bonds	5.28	5.08	5.01
30-Year Fixed Mortgage †	6.68	6.42	6.50

† BankQuote Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10YR. BOND	30YR. BOND
General Obligations	4.18%	4.62%
Taxable Equivalent	5.97	6.60
Insured Revenue Bonds	4.25	4.73
Taxable Equivalent	6.07	6.76

THE WEEK AHEAD

RESIDENTIAL CONSTRUCTION

Tuesday, June 19, 8:30 a.m. EDT

Housing starts are expected to have fallen back to an annual pace of 1.49 million units in May. That's the consensus forecast among economists surveyed by Action Economics. In April, starts posted a better-than-expected increase, to 1.53 million. The markets also will look at the number of housing permits issued after an April dip. Housing data

have been erratic this year, in part because of volatile weather during the winter and spring.

INITIAL UNEMPLOYMENT CLAIMS

Thursday, June 21, 8:30 a.m. EDT

New filings for state unemployment claims probably came in near 310,000 for the week ended June 16. Claims inched down to 309,000 in the week of June 2. The results during May showed scant signs of the labor market weakening.

LEADING INDICATORS

Thursday, June 21, 10 a.m. EDT The Conference Board's leading economic indicators index for May most likely rebounded, with a 0.3% increase. A decline in initial jobless claims and a stock market rally should help overcome a decline in the average workweek for factory workers. In April the index declined 0.5% on weakness in the housing market and a small uptick in unemployment claims.

The *BusinessWeek* production index climbed to 303.4 for the week ended June 2, an 8.3% gain from a year ago. Before calculation of the four-week moving average, the index nudged up to 304.6.

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For the BW50, more investment data, and the components of the production index visit businessweek.com/extras.

Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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It's about money.
Earning it.
Investing it.
Spending it.



Check out this weekend's show
airing June 16 and 17:

Housing Slump: Get help with navigating this tough market and assessing whether the home you want is within reach.

Will the iPhone Deliver?: Our Technology Editor shares his perspective on this year's most-hyped tech release.

Summer Relaxation: We've got tips on great vacation deals, plus a few suggestions for what to read while you're on holiday.

Golf Gadgets: The latest gear helps your game, from mapping courses with GPS to measuring the power of your swing.

BusinessWeek weekend

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Paperbacks for Balmy Days

Compiled by Hardy Green

Isn't playing the stock market just gambling? Yes, says Morgan Stanley executive Aaron Brown—and a good thing, too! Brown, a risk manager and former trader with degrees in applied math from Harvard University and finance from the University of Chicago, says finance would be tepid and

ineffectual without the vitality imparted by the gambling instinct. His book, **The Poker Face of Wall Street** (Wiley, \$16.95, coming in July), is a sprawling, idiosyncratic, and sometimes poker-obsessed work filled with nuggets about American history and finance. Quirky insights make the book special, according to reviewer Peter Coy.

Not for you? Well it's only one of the several volumes in *BusinessWeek's* annual roundup of paperbacks published just in time for the lemonade-and-hammock season.

Are layoffs an unavoidable fact of life? No, says *New York Times* economics reporter Louis Uchitelle. In **The Disposable American: Layoffs and Their Consequences** (Vintage, \$14.95), Uchitelle draws upon mounds of research to show the folly of such an approach. Dumping workers only seems to be economical, he says, pointing to a plethora of hidden costs that include severance, potential lawsuits from aggrieved workers, loss of institutional memory and trust in management, a shortage of staff when the economy rebounds, rehiring expenses, and a culture of survivors who are risk-averse, paranoid, and alienated. Contrast that with the no-layoff payoff: fierce loyalty, higher productivity, and superior innovation. Reviewer Michelle Conlin said the author makes a strong case that layoffs should be the last place CEOs turn in times of trouble, not the first.

Snap judgments have a bad rep, says Malcolm Gladwell, one that's not always justified. In **Blink: The Power of Thinking Without Thinking** (Back Bay Books, \$15.99), *The New Yorker* writer asserts that on-the-spot decision makers can be very insightful. He relates the story of a psychologist who, after listening for only a few minutes to a couple's casual conversation, can tell they are headed for a divorce. Not all snap judgments are spot-on, concedes the author. The key to effective decisions is what he calls "thin-slicing," or instantly homing in on a few salient details. Gladwell's aim is to help everyone make better choices, no matter how much or how little time they take. Reviewer Diane Brady called the volume "concise and provocative."



New York Governor Eliot Spitzer seems an up-and-comer. But what is to be made of his controversial career so far? Has he been a populist crusader who stepped into a regulatory vacuum—or an overzealous, self-aggrandizing bully? To

review the record, consider **Spoiling for a Fight: The Rise of Eliot Spitzer** by Brooke A. Masters, a senior business reporter for the *Financial Times* (Owl Books, \$16). Reviewer Michael Orey found the book to be an evenhanded compendium of Spitzer-led high-profile cases involving tainted research by Wall Street analysts, improper mutual fund trading, and rigged bidding in insurance. What's missing, though, is a clear judgment of Spitzer by the author, a failing that may disappoint readers.

How often do you have an opportunity to observe skilled workers produce a masterpiece? Well, here's your chance to follow a single piano, No. K0862, on its yearlong journey through Steinway & Sons' New York City factory and on to the company's storied concert division, where instruments are earmarked for loans to artists and institutions. The artisanal process has changed little over the centuries, as you can discover in the pages of **Piano: The Making of a Steinway Concert Grand** (Times Books, \$15) by *New York Times* reporter James Barron. The author leavens his account with tales of the waxing and waning of Steinway company fortunes, a





19th century rivalry with Chickering & Sons, and details of marketing schemes from yesteryear.

Like Dobie Gillis' sidekick, Maynard G. Krebs, we all might like to flee from work, at least during the summer. But there is no escape. In **Toxic Emotions at Work** (Harvard Business School Press, \$14.95), Peter J. Frost describes the debilitating effects of his own on-the-job stress: "Issues that once might have stayed with me emotionally for only a few hours soon began to keep me awake for nights on end." Frost, a business professor at the University of British Columbia, focuses on this toxicity, which, as "a normal by-product of organizational life," he insists cannot be avoided, only managed.

This useful volume examines the sources of organizational distress, considers how "toxin handlers"—those, such as project managers, who often have to help others through difficult periods—can protect themselves, and suggests ways to construct more compassionate workplaces.

Readers fond of accounts describing the broad sweep of history will enjoy **1491: New Revelations of the Americas Before Columbus** by Charles C. Mann (Vintage, \$14.95). A correspondent for *Science* and *The Atlantic*, Mann taps into recent scholarship that challenges the conventional wisdom about Native American culture, society, and politics. The revisionists argue that pre-

Columbian America did not consist of a pristine landscape, home to a relatively small number of illiterate and innumerate people living close to the land. Instead, vast civilizations had long flourished throughout the Americas, especially below the Rio Grande. The Maya and Aztec civilizations, as well as the lesser-known Tiwanaku and Wari, among others, built giant cities with magnificent architecture and lively intellectual life.

With a new book in print, former Chrysler Chairman Lee Iacocca is back in the news. His publisher has taken advantage of the occasion to reissue the 1984 megaseller **Iacocca: An**

Autobiography (Bantam, \$15). This is the book that made almost every CEO say: Hey, I should have a book, too! A good bit of what's in this memoir, such as his section on "the Japanese challenge," is of historical interest only. But his account of the turnaround at Chrysler still resonates: "There was so much to do and so little time! I had to eliminate the thirty-five little duchies. I had to bring some cohesion and unity into the company. I had to get rid of the many people who didn't know what they were doing..." It's an intriguing account of a singular American life.

Another author who has benefited from recent publicity is Stanford University management professor Robert I. Sutton, author of the just-published *The No Asshole Rule*. Now, his 2002 book, **Weird Ideas That Work: How to Build a Creative Company**, is finally out in paperback (Free Press, \$14). Among its offbeat notions: Reward both success and failure, but punish inaction. Encourage people to ignore and defy authority. And "find some happy people and get them to fight"—meaning you should hire upbeat staff and foster sharp conflict over their competing ideas. Each of Sutton's 11½ maxims is the subject of its own chapter. The author's wit and erudition make *Weird Ideas That Work* a pleasure to read.

Finally, those who need a bit of quality fiction should consider **Suite Française** by Irene Nemirovsky (Vintage, \$14.95), a tale of France under Nazi occupation that was apparently written during the period described. Although the book was never finished—the author, a Jew, died in Auschwitz in 1942—its two extant sections are engrossing. The first of these shows the panic afflicting a cross section of Parisian society as the German armies approach. Among those fleeing the capital are an upper middle-class Catholic family; a snobbish, successful writer and his mistress; a boorish bank manager and two employees; and an effete art collector who'll do anything to save himself. There are moments when this section resembles a French *Grand Hotel*, populated by class-conscious stock characters. But the author's ear for conversation and way with minor characters make up for any failings. And the book's second section, on the German occupation of a small town, is quite affecting, especially in its treatment of the growing closeness between a lonely French woman and a cultured German lieutenant. ■■

From "weird ideas" to Iacocca, here's what to put in your beach bag



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From Peak Oil to Dark Age?

With global oil production virtually stalled in recent years, controversial predictions that the world is fast approaching maximum petroleum output are looking a bit less controversial. At first blush, those concerned about global warming should be delighted. After all, what better way to prod the move toward carbon-free, climate-friendly alternative energy?

But climate change activists have nothing to cheer about. The U.S. is completely unprepared for peak oil, as it's called, and the wrenching adjustments it would entail could easily accelerate global warming as nations turn to coal. Moreover, regardless of the implications for climate change, peak oil represents a mortal threat to the U.S. economy.

Peak oil refers to the point at which world oil production plateaus before beginning to decline as depletion of the world's remaining reserves offsets ever-increased drilling. Some experts argue that we're already there, and that we won't exceed by much the daily production high of 84.5 million barrels first reached in 2005. If so, global production will bump along near these levels for years before beginning an inexorable decline.

What would that mean? Alternatives are still a decade away from meeting incremental demand for oil. With nothing to fill the gap, global economic growth would slow, stop, and then reverse; international tensions would soar as nations seek access to diminishing supplies, enriching autocratic rulers in unstable oil states; and, unless other sources of energy could be ramped up with extreme haste, the world could plunge into a new Dark Age. Even as faltering economies burned less oil, carbon loading of the atmosphere might accelerate as countries turn to vastly dirtier coal.

GIVEN SUCH UNPLEASANT possibilities, you'd think peak oil would be a national obsession. But policymakers can hide behind the possibility that vast troves will be available from unconventional sources, or that secretive oil-exporting nations really have the huge reserves they claim. Yet even if those who say that the peak has arrived are wrong, enough disturbing omens—for example, declining production in most of the world's great oil fields and no new superfields to take up the slack—exist for the issue to merit an intense international focus.

The reality is that it will be here much sooner for the U.S.—in the form of peak oil exports. Since we import nearly two-thirds of the oil we consume, global oil available for

export should be our bigger concern. Fast-growing domestic consumption in oil-exporting nations and increasing appetites by big importers such as China portend tighter supplies available to the U.S., unless world production rises rapidly. But output has stalled. Call it *de facto* peak oil or peak oil lite. It means the U.S. is entering an age when it will have to scramble to maintain existing import levels.

We will know soon enough whether the capacity to raise production really exists. If not, basic math and the clock tell the story. All alternatives—geothermal, solar, wind, etc.—produce only 3% of the energy supplied by oil. If oil demand rises by 2% while output remains flat, generation of alternative

energy would have to expand 60% a year. That's more than twice the rate of wind power, the fastest-growing alternative energy. And all this incremental energy would somehow have to be delivered to transportation (which consumes most of the oil produced each year) just to stay even with the growth in demand.

Nuclear and hydropower together produce 10 times the power of wind, geothermal, and solar power. But even if nations ignore environmental concerns, it takes years to build nuclear plants or even identify suitable undammed rivers.

There are many things we in the U.S. can do (and should have been doing) other than the present policy of crossing our fingers. If an oil tax makes sense from a climate change perspective, it seems doubly worthy if it extends supplies. Boosting efficiency and scaling up alternatives must also be a priority. And, recognizing that nations will turn to cheap coal (recently, 80% of growth in coal use has come from China), more work is needed to defang this fuel, which produces more carbon dioxide per ton than any other energy source.

Even if the peakists are wrong, we would still be better off taking these actions. And if they're right, major efforts right now may be the only way to avert a new Dark Age in an overheated world. ■

Eugene Linden is author of *The Winds of Change: Climate, Weather, and the Destruction of Civilizations*.

**Oil output
has stalled,
and it's not
clear the
capacity
exists to raise
production**

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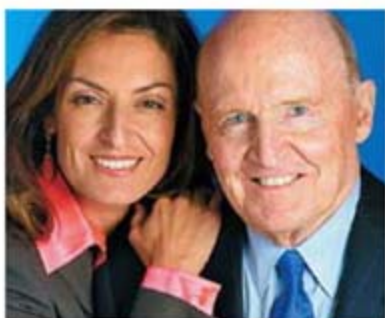


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Lay Off the Layers

We're constantly being told that hierarchies are bad and we must flatten companies to make them more effective, but don't companies need some layers in order to organize for success?

—David Gionet, Toronto

Don't take another step—you're right at the edge of the old "Come on, one more layer won't hurt us" slippery slope that has tripped up more managers and companies than perhaps any other natural disaster. O.K., maybe "natural disaster," is too strong a term, but the organizational compulsion to insert layers is just about as inexorable as, say, hurricane season every year. And it can be just as damaging. The only difference is that layers can be prevented. And they must be.

The reasons, as you suggest, should not be new to anyone. First of all, in a world where faster is not just better but necessary, layers slow everything down. Take decision-making. The more layers, the more people who have to thump their rubber stamp. The more PowerPoint presentations to be made to bosses and bosses' bosses before the rubber stamp. Or take communicating change.

Layers make that process—hard enough as it is—like that children's whispering game, telephone. Every time a piece of information passes through a person, it morphs a little. Layers do that, too, adding spin, interpretation, and buzz with every telling. Or take getting a business going. Layers bury startups, particularly within large companies, under piles of bureaucrats and processes, depriving any entrepreneurial venture of the oxygen and sunlight it needs to thrive.

Perhaps the worse outcome of layers is meddling. When there are a lot of layers, it usually means managers have too few people reporting to them. Tom in Kansas City can have, basically, three sales reps he's responsible for, or Maria in Toronto can be boss to two financial analysts and an administrative assistant. So what do Tom and Mary do with their massive underutilization? They end up babysitting their direct reports, or worse, doing their jobs for them. Talk about killing morale and initiative!

But not to harp on the all-too-familiar consequences of layers. Your job is to fight them, even if it is against your organization's gravitational pull. After all, layers pop up because they seem necessary, especially with growth. "Uh-oh,

we've got more sales," people say, "We'll need more district managers in the field." Or, "More employees? Better add a few positions at headquarters." Ironically, even when there isn't growth, companies feel compelled to add layers. Often this form of layering masquerades as promotions, as in, "Look, people are still moving up around here!" To be sure, such promotions don't have raises attached—but they're better than nothing. Wrong.

So what is right when it comes to layers? You'll know you're there if you're, well, uncomfortable. That is, you've probably gotten to the right level of layers if your company is 50% flatter than you'd like. Managers should have eight direct reports at the minimum and up to a dozen if they're experienced. CEOs should have more. Indeed, the higher you are in an organization, the more direct reports you should have. After all, senior people should be good enough to operate without their boss's constant glare. That's why they're senior.

Look, we're not saying this is the end of the world. We're just saying you should think of every layer as a bad layer. And like a hurricane, if you see one coming your way, batten down the hatches. Better yet, escape to higher ground and let the danger pass you by.

More and more, I see people hiding behind e-mail. If you don't have the guts to say it in person, don't send it in an e-mail. What do you think?

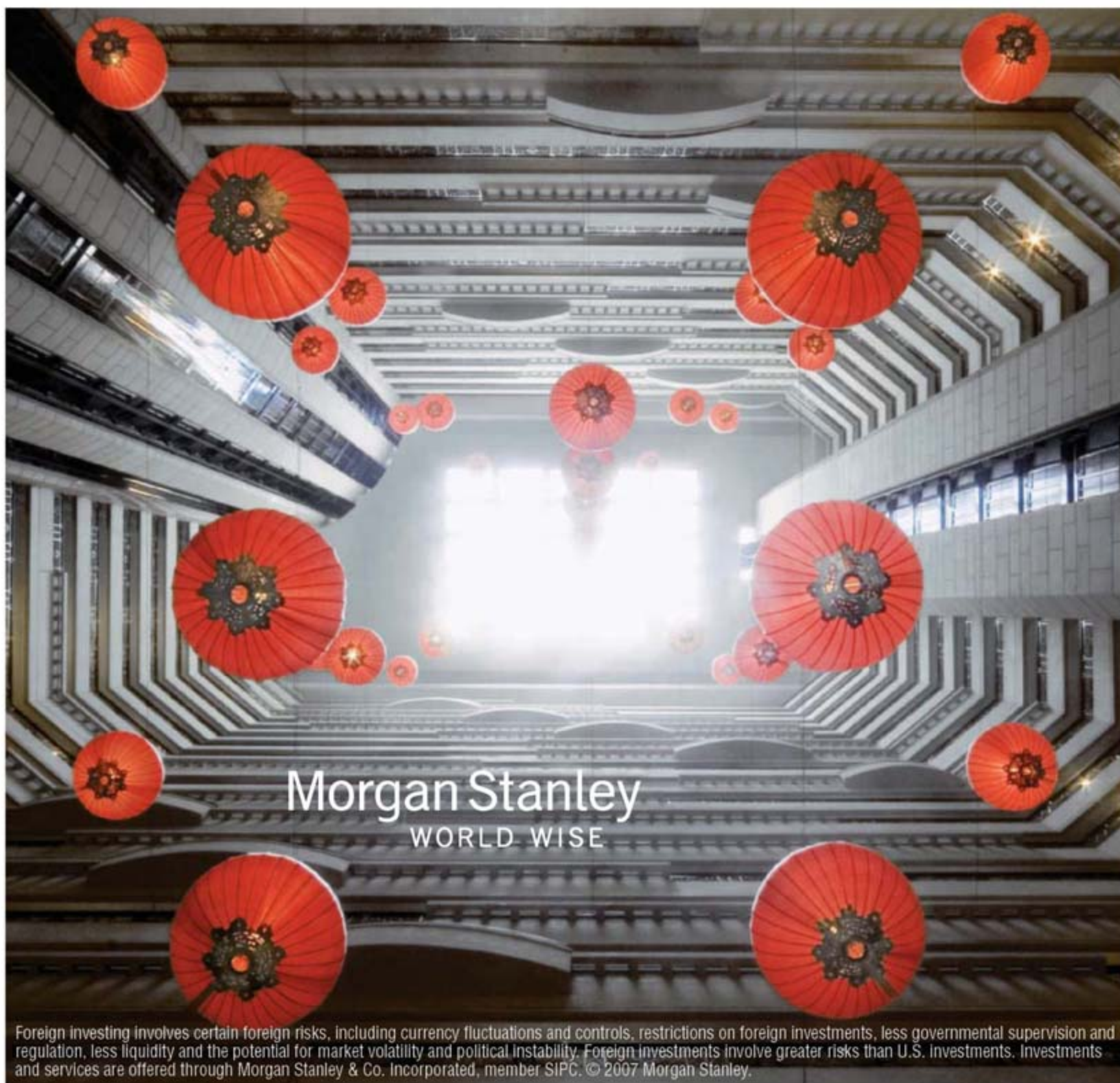
—John Martin, Overland Park, Kan.

In general, we'd rank e-mail right up there as one of the great, transformative innovations of all time in that you can say: "It changed everything." E-mail has made business faster, more competitive, and more global. It has opened up whole new ways of working and conducting commerce. Indeed, just recall that day recently when BlackBerry's went offline due to a technological snafu. For 24 hours, the business world was forced to remember life before instant information and communication. No one felt nostalgic. They felt helpless.

That said, you're definitely right that e-mail allows people to deliver hard messages from a distance, like throwing a punch from another room. We don't know the antidote for that dynamic, except for each person to fight it personally by asking, "Should I say this face-to-face?" before pushing the send button. If you feel squeamish, the answer is yes. Hard as it is, stop typing—and start talking instead. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at thewelchway@businessweek.com. For their weekly podcast, go to businessweek.com/search/podcasting.htm.

The more layers in a business, the more spin, meddling, and worst of all, delays



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